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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM 1942

No. 1008

IN THE MATTER

of

PRUDENCE-BONDS CORPORATION,

Debtor.

IN THE MATTER of the Application of CHARLES H. KELBY and CLIFFORD S. KELSEY, as Trustees of the Debtor, and PRUDENCE-BONDS CORPORATION (New Corporation), for an order herein restraining and enjoining all parties to a certain action in the Supreme Court of the State of New York, New York County, entitled "Brooklyn Trust Company, as Trustee under the will of Susanna E. Coffin, deceased, Plaintiff, against President and Directors of the Manhattan Company; George E. Eddy; Hilda S. Reese; and Prudence-Bonds Corporation (New Corporation)," from taking any further steps and proceedings therein.

BROOKLYN TRUST COMPANY, as Trustee of a trust created in and by the will of Susanna E. Coffin, deceased,

Petitioner.

against

CHARLES H. KELBY and CLIFFORD S. KELSEY, as Trustees of the Debtor; PRUDENCE-BONDS CORPORATION (New Corporation); GEORGE E. EDDY; HILDA S. REESE; and PRESIDENT AND DIRECTORS OF THE MANHATTAN COMPANY,

Respondents.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF

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BROOKLYN TRUST COMPANY, as Trustee of a trust created in and by the will of Susanna E. Coffin, deceased,

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable the Chief Justice of the Supreme Court of the United States of America and the Honorable the Associate Justices thereof:

Brooklyn Trust Company, as trustee under the will of Susanna E. Coffin, deceased, respectfully prays for a writ of certiorari to review the decision and order of the United States Circuit Court of Appeals for the Second Circuit in the above cause, affirming an order of the United States District Court for the Eastern District of New York entered on August 3, 1942, which order restrains the prosecution or defense of a certain action in the Supreme Court of the State of New York, County of New York, entitled, "Brooklyn Trust Company, as Trustee under the will of Susanna E. Coffin, deceased, Plaintiff, against President and Directors of the Manhattan Company; George E. Eddy; Hilda S. Reese; and Prudence-Bonds Corporation (New Corporation), Defendants."

Opinions Below

The opinion of the District Court (R. 832-854)* is not reported. The opinion of the Circuit Court of Appeals (R. 913-996) is reported in 134 F. 2d, 105.

Jurisdiction

The opinion of the Circuit Court of Appeals was rendered February 16, 1943, and the order for the mandate thereon was entered March 7, 1943. The jurisdiction of this Court is invoked under Section 240a of the Judicial Code, as amended by Act of Congress of February 13, 1925, (U. S. Code, Title 28, Section 347).

Questions Presented

1. Has a District Court in bankruptcy, in a proceeding under Section 77B of the Bankruptcy Act in which the plan of reorganization has been consummated, power to enjoin

* References unless otherwise stated are to folios of transcript.

an action in a state court by a former bondholder of the debtor, which sold its bond prior to the reorganization, against a former indenture trustee of the debtor which has turned over all the debtor's property pledged thereunder to a new trustee pursuant to the plan of reorganization, such action being for damages payable out of the personal property of the defendant?

2. Has such District Court in bankruptcy jurisdiction in a summary proceeding over a person who is not and was not a creditor of the debtor in reorganization and who asserts no claim to any property of the debtor where such person seeks to litigate a claim for damages against a bank which formerly had possession, as indenture trustee, of some of the debtor's pledged property, for breaches of trust in surrendering a part of such pledged property to the debtor while such person was the owner of a bond of the debtor sold by such person prior to the commencement of the reorganization proceeding?

3. If the Bankruptcy Act is construed to sustain the power exercised herein by the District Court in bankruptcy, does it deprive the estate of Susanna E. Coffin, a former bondholder of the debtor, of a right guaranteed by the Fifth Article of the Articles in addition to and amendment of the Constitution?

Statement of Facts

Preliminary Statement

The petitioners for the restraining order were the debtor's 77B trustees, who are not parties to the state court action, and the new corporation formed pursuant to the reorganization proceeding (R. 34). Hilda S. Reese, a bondholder named as defendant in the action, supported the petition but did not join in it. George E. Eddy, another bondholder named as defendant in the action, appeared but neither opposed nor supported the application (R. 27).

Petitioner appeared specially and denied the jurisdiction of the Court to entertain the petition (R. 190-195).

The injunction continues until after the final decree in the proceedings pending in the District Court for the judicial settlement of the accounts of all of the corporate trustees of the debtor's eighteen series of bonds (R. 30-33).[1] The order, affirmed by the Circuit Court of Appeals, also denied this petitioner's motion to dismiss the petition for such restraining order (R. 29).

The reorganization proceedings

The debtor, a New York business corporation, filed its petition for reorganization on June 29, 1934. It had outstanding eighteen series of bonds aggregating about fifty-six million dollars. Each series was secured by a substantially similar trust agreement made by the debtor with a bank as trustee under which securities were pledged and deposited by the debtor with each trustee as security for the payment of the bonds (R. 38).

Separate plans for each of the series of bonds and a general plan providing the mechanics for carrying out the separate plans were confirmed by the District Court January 18, 1938, (R. 44, 47, 255).[2] Under the general plan, the debtor having been adjudicated insolvent, (R. 42 and 254) a new corporation was to be created; its stock was to be placed in a voting trust until March 1, 1943; the voting trust certificates were to be distributed pro rata among the bondholders (R. 45); the debtor and its 77B trustees were to

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[1] That the injunction was a restraint of the parties and was not formally directed against the state court itself (R. 849, 30-33) is immaterial. (*Hill* v. *Martin*, 296 U. S. 393, 403; *Henderson* v. *Fleckinger*, 48 F. Supp. 236, 240.)

[2] The Circuit Court of Appeals in its opinion (R. 922) stated that the order approving the reorganization plans in its entirety was affirmed by that Court. *In re Prudence-Bonds Corporation*, 79 F. 2d 205. While this statement is not important it is erroneous. The decision cited was made on August 8, 1935, several years before this order was made and related to the debtor's right to propose separate plans.

transfer all of their right, title and interest to the new corporation which was to assume and agree to pay the bonds as modified and extended to May 1, 1945. Under each of the separate plans for the several series a separate new trust agreement was to be made and each of the corporate trustees under the original agreements was to transfer the securities held by it to the new corporate trustee (which was formed on February 8, 1938), (R. 50-53).

The District Court by an order made on April 27, 1938, approved the form of the new trust agreement; designated a new trustee; directed the debtor and its trustees to assign all of their right, title and interest in the collateral securing the payment of the bonds to the new corporation; directed each of the former corporate trustees to deliver the collateral constituting the trust funds in its hands to the new trustee and to file an account of its acts and to apply to that Court for the judicial settlement thereof (R. 50-53).

The debtor and its trustees conveyed all of their right, title and interest in all of the trust fund collateral to the new corporation and the bankruptcy court thus surrendered the control it had over the same (R. 53), a new agreement with respect to each of the series of bonds was entered into between the new corporation and the new trustee (R. 53), and the former corporate trustees transferred and delivered all of their respective trust fund collateral in their hands to the new trustee (R. 257-258 and pp. 380-387, former record, *Manufacturers Trust Company* v. *Kelby,* 125 F. 2d 650).

The accounting proceedings

Each of the former corporate trustees thereafter filed an account (R. 54, 68, 69) of its acts and a petition praying that the Court judicially settle the same and discharge it from liability with respect to its acts from the date of each respective agreement.

A question was raised as to the jurisdiction of the bankruptcy court (R. 58) which ruled by order on January 9,

1939, that it had no jurisdiction over the accounts and objections that might be made thereto in so far as they related to acts of the accounting trustees prior to the date of commencement of the reorganization proceeding in permitting the debtor to withdraw some of the trust fund collateral in alleged violation of the trust agreements (pp. 421, 422 former record). Upon appeal the order of the District Court was reversed by the Circuit Court of Appeals. (*Central Hanover Bank & Trust Company, et al.* v. *Manhattan Company et al.*, 105 F. 2d 130.)

While the Circuit Court of Appeals decided that the District Court was not without jurisdiction over the claims of then bondholders which related to the acts of the accounting trustees prior to June 29, 1934, in permitting the debtor to substitute or withdraw collateral, it decided that the District Court *might* if it saw fit include such claims in the accountings; that it did not follow that it will prove more convenient to do so and the District Judge was free to choose that forum which he thought would best serve the interests of all parties.

The District Court thereupon made an order on July 12, 1939, in which it stated that "to make effective, consummate and carry out" the confirmed plans, it had and thereby took "full, complete and exclusive jurisdiction" over the accounts and objections thereto, including objections to acts of the corporate trustees in permitting the alleged substitutions and withdrawals of collateral by the debtor (R. 60-64).

On October 2, 1939, the new corporation and the debtor's trustees filed objections to the accounts of all but one of the corporate trustees (R. 70-77). Objections to the accounts of some of these trustees were filed by individual bondholders on behalf of all bondholders (R. 70-77). The accounts and objections were referred to a Special Master (R. 78). The objections to such accounts relate mainly to the trustee's acts in permitting the debtor to (1) withdraw bonds and mortgages upon the substitution of other bonds and mort-

gages and/or cash and (2) excess cash from the respective trust funds in alleged violation of the agreements (R. 71).[3]

Manufacturers Trust Company, former trustee of the twelfth series, and Brooklyn Trust Company, former trustee of the eighth series, while hearings on objections to certain other accounts were pending before the Special Master, moved before him for summary judgment dismissing all of the objections to their accounts other than those of certain individual bondholders on the ground that the objectors were not real parties in interest and had no standing to maintain objections; and on the further ground that they were barred by the statute of limitations (R. 81). The Special Master by report in each case dated April 17, 1941, recommended that the motions be granted in so far as they sought dismissal of the objections of the new corporation, the debtor's trustees and Prudence Securities Advisory Group, an intervening objector; that no bondholder had the right to object to the accounts on behalf of bondholders as a class and that bondholders who acquired their bonds after the acts objected to had no right to object. The Special Master recommended the denial of the motions in so far as they sought dismissal of the objections on the ground they were barred by the statute of limitations (R. 81).

The District Court on July 10, 1941, reversed the Special Master in part and denied the motions in all respects (p. 500, former record). Both banks appealed from the respective orders denying their motions. The appeal of Brooklyn Trust Company was held in abeyance pending the outcome of the appeal of Manufacturers Trust Company.

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[3] There is no claim that the accounts as rendered are false or inaccurate or incomplete. They are *qua* accounts; therefore not contested. They are merely informative the same as a bill of particulars; a statement of undisputed transactions, and they now serve only as a fact basis by which bondholders seek damages. Nor is there any process of identification of trust *res* in the hands of the former trustees, which is usually a process of accounting, involved here.

The Circuit Court of Appeals on said appeal (*Manufacturers Trust Company* v. *Kelby,* 125 F. 2d 650) ruled (1) that a former bondholder or assignor of a bond of the debtor who transferred his bond prior to the debtor's reorganization had no standing to complain of the substitutions and withdrawals of a part of the collateral of the debtor permitted by the corporate trustees while he was a bondholder and before the assignment of such bond; (2) that, being a question as to the effect of an assignment of a bond made in New York, the decisions in that state are authoritative; (3) that the causes of action based on such acts on the part of the corporate trustees were in their nature derivative and that the bondholders at the time of any recovery were entitled to the benefits thereof; and (4) neither the debtor's trustees nor the new corporation were indispensable parties to the accounting proceeding. Petition for certiorari was denied, 316 U. S. 697. The appeal of Brooklyn Trust Company was thereafter withdrawn.

The complaint in the state action

The state action, in which petitioner here sues as trustee of a testamentary trust and not in any individual capacity or as trustee of any bonds formerly issued by the debtor, was instituted on June 24, 1942. Plaintiff therein sued in the fulfilment of its duty as a testamentary trustee to enforce rights which it possesses as such for the benefit of beneficiaries and remaindermen of the testamentary trust who are the real plaintiffs in the action (R. 248).

The complaint alleges that Susanna E. Coffin bought a one-thousand-dollar Prudence bond, fifth series, on January 18, 1926, and held it at her death on November 4, 1931 (R. 245-248). On March 28, 1932, more than two years prior to the filing of the debtor's petition for reorganization, this petitioner as executor of Mrs. Coffin's will, sold the bond for five hundred eighteen dollars and seventy-five cents (R. 250) and later turned the residuary estate, including the proceeds of the bond, over to itself as testa-

mentary trustee, accounting and being discharged as executor, and it is now acting as trustee for the beneficiaries and remaindermen of said trust (R. 251); that between January 18, 1926, when testatrix bought the bond, and March 28, 1932, when it was sold, Manhattan Company, as trustee of the series, allowed the debtor to withdraw cash and bonds and mortgages not in default while other mortgages were in default, in violation of the trust agreement and to the damage and injury of testatrix, her estate and plaintiff (R. 248-250).

The indenture under which Manhattan Company became trustee, the issuance of the bonds and the subsequent reorganization of the debtor are alleged (R. 243-245, 252-259).

It is then alleged that pursuant to order of the District Court, defendant Manhattan Company filed an account of its acts as trustee (R. 259) and that objections were filed by defendants Eddy and Reese on behalf of themselves and all other then bondholders (R. 260).

The nature of these objections is then set forth (R. 260-263) showing they assert that no sum recovered from Manhattan Company for its acts committed between January 18, 1926 and March 28, 1932 will be payable to the Coffin Estate or others who owned bonds at the time of such acts and later sold their bonds but that any amount so recovered will be added to the collateral securing the *modified* fifth series bonds for the benefit of the bondholders of this series at the time of such recovery and, if their bonds are paid in full, for the benefit of other parties *who are not bondholders of this series.*

It is then alleged and cannot be denied that petitioner and other former bondholders of the debtor who sold their bonds prior to the institution of the debtor's reorganization proceeding were parties neither to this reorganization proceeding nor to the proceeding to settle the accounts of the corporate trustees, since they were neither creditors of nor claimants against the debtor or its property when either proceeding was instituted (R. 263-264) and were never classified as such (R. 298-327).

The decision of the Circuit Court of Appeals in *Manufacturers Trust Company* v. *Kelby, supra,* is set forth and it is alleged that it does not conform to the law of New York and is not an authority binding upon its courts (R. 265-267).

The prayer for relief is for a money judgment against Manhattan Company in its individual capacity (R. 267).

This action therefore does not attempt to reach any property or *res* which ever constituted a part of the debtor's estate or over which the bankruptcy court had, has or can obtain jurisdiction.

The action is pending only against Manhattan Company and Prudence-Bonds Corporation (New Corporation) (R. 99, 198-201, 213-214, 232). Eddy and Reese, while named parties defendant, have not been served with process and have not appeared in the action; consequently, no action is pending as to them. No judgment recovered will be *res adjudicata* as to them unless they are served with process or appear therein.

Facts alleged in the petition for injunction

The petition on which the restraining order was granted sets forth at length the steps, beginning on June 29, 1934 in the proceedings for the reorganization of the debtor to and including the denial by this Court on June 21, 1942 of certiorari to review the decision of the Circuit Court of Appeals in *Manufacturers Trust Company* v. *Kelby,* which facts have been summarized.

The petition also alleges settlement of objections to the accounts of three trustees of certain of the debtor's series of bonds, the relevancy of which is not apparent upon the issue presented and the same applies to what follows in the petition.

The petition further alleges circumstances surrounding the commencement of the action in the state court and that petitioner is testamentary trustee and trustee of another trust in which it holds other bonds of the debtor and has not commenced any action or proceeding or asserted any

claim or assignment with respect thereto or filed in the debtor's proceeding any proof of claim asserting any right to any portion of any recoveries for the acts complained of in the objections to the account of Manhattan Company (R. 96-110);

That the action commenced in the state court constitutes an unlawful interference with the processes and proceedings of the District Court in connection with the administration of the debtor's estate under the Bankruptcy Act and an unlawful interference with the proceedings for the settlement of the accounts of the corporate trustees of the various series of bonds of the debtor over which the District Court has jurisdiction (R. 110);

That it appears from the *amended* complaint in the action (since superseded by a second amended complaint) (R. 241-267), that the principal object and effect of the action is and would be to review, circumvent and render ineffectual the order of the District Court dated August 29, 1941, in the *Brooklyn Trust Company* case (Eighth Series) and the order and decree made on September 3, 1941, in the *Manufacturers Trust Company* case (Twelfth Series) as affirmed by the Circuit Court of Appeals, and the order and decree made on July 12, 1939, on the mandate of the Circuit Court of Appeals filed July 1, 1939, in *Central Hanover Bank and Trust Company* v. *Manhattan Company, supra*, and that unless the parties are restrained from taking any further proceedings until after the final decree the further result will be that petitioner and other parties and bondholders interested in the debtor's estate and the accounting proceedings herein will needlessly be required to perform substantial services and incur substantial expenses, all or part of which will be chargeable to the trust funds, and impede and delay the closing of the debtor's estate (R. 110-119). It is lastly alleged that the action in the state court has not been instituted in good faith (R. 119-128), which is not germane and which is solely a matter for decision by the state court.

Specifications of errors to be urged

The Circuit Court of Appeals erred in the following respects:

(1) In holding, in conflict with both New York law and the decisions of this Court, that the institution and maintenance of the action by this petitioner in the state court interferes with any jurisdiction of the bankruptcy court.

(2) In holding, in conflict with both New York law and the decisions of this Court, that any recovery by petitioner in the action in the state court from Manhattan Company will interfere with any jurisdiction of the bankruptcy court.

(3) In holding, in conflict with the decisions of this Court and other Circuit Courts of Appeals and its own former decisions, that the District Court had power, authority and jurisdiction to restrain petitioner by a summary proceeding from prosecuting its action in the state court.

(4) In confirming and relying upon its decision in *Manufacturers Trust Company* v. *Kelby* and in holding, in conflict with New York law, that a corporate bondholder's cause of action against a trustee under an indenture securing the payment of bonds for breaches of trust, which consist of the surrender or release of portions of the pledged or mortgaged property to the debtor-obligor while he was such a bondholder, passes *ipso facto* with a transfer of the bond and is inseparable from it.

(5) In holding, in conflict with New York law, that a derivative suit may be maintained on behalf of the bondholders' security against a trustee under an indenture securing the payment of the bonds for breaches of trust in connection with the pledged or mortgaged property which do not involve the acquisition of title to or an appropriation of such property by the trustee individually and its possession thereof or of its substitute.

(6) In holding, in conflict with New York law, that a derivative suit may be maintained on behalf of the bondholders' security against a trustee under an indenture securing the payment of the bonds for breaches of trust in surrendering or releasing portions of the mortgaged or pledged property to a debtor-obligor.

(7) In holding, in conflict with New York law, that a suit may be maintained by a bondholder against a trustee under an indenture securing the payment of bonds for breaches of trust in connection with the surrender or release of a portion of pledged or mortgaged property to a debtor-obligor, which acts occurred prior to the time he became a bondholder.

(8) In holding, contrary to its two former rulings, that the proceeding in the District Court for the judicial settlement of the account of Manhattan Company is a proceeding in or a part of the debtor's reorganization proceeding subject to the jurisdiction of the bankruptcy court.

(9) The decision of the Circuit Court of Appeals deprives petitioner and other former corporate bondholders similarly situated, that is, who were such when a trustee under an indenture securing the payment of such bonds surrenders some of the pledged property which secured the bonds to the debtor-obligor, of their property without due process of law.

Reasons for granting the writ

The Circuit Court of Appeals, as will be shown in the brief herewith, has:

1. Decided a Federal question in conflict with applicable decisions of this Court and of other Circuit Courts of Appeals and of its own former decisions.

2. Construed a Federal statute so as to render it unconstitutional.

3. Decided an important question of New York property law in conflict with applicable New York decisions and with those of this Court.

4. The propositions of law involved are of public important since they affect the property rights of a great number of former holders of corporate bonds not only of the debtor but of other corporations. Since the decision of the Circuit Court of Appeals is inconsistent with the law of New York, the rights of bondholders and the nature of the liability of trustees under indentures securing the payment of bonds depends now and until the questions herein presented depend upon whether a suit is brought by a bondholder in a New York State Court or in a Federal Court.

Conclusion

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari should be granted to review said decisions and order of the Circuit Court of Appeals for the Second Circuit.

Dated, Brooklyn, New York,
May 6, 1943.

BROOKLYN TRUST COMPANY,
as Trustee under the will of
Susanna E. Coffin, deceased,
Petitioner,

By: JACKSON A. DYKMAN and
RALPH W. CROLLY,
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I

The decision of the Circuit Court of Appeals in affirming the injunction is in conflict with the following decisions of this court: *Mandeville* v. *Canterbury*, 63 S. Ct. 472; *Toucey* v. *New York Life Ins. Co.*, 314 U. S. 118; *Southern Ry.* v. *Painter*, 314 U. S. 155; *Chicago* v. *Fieldcrest Dairies*, 316 U. S. 168; *Railroad Comm'n* v. *Pullman Company*, 312 U. S. 496; *Md. Casualty Co.* v. *Pacific Co.*, 312 U. S. 270; *Texas* v. *Donoghue*, 302 U. S. 284; *Kline* v. *Burke Construction Co.*, 260 U. S. 226; *Foust* v. *Munson S. S. Lines*, 299 U. S. 77; *Commonwealth Company* v. *Bradford*, 297 U. S. 613; *Riehle* v. *Margulies*, 279 U. S. 218.

Whether the proceeding to judicially settle the account of Manhattan Company is a proceeding in the bankruptcy reorganization, which was consummated in 1938, or is an independent proceeding over which the District Court, but not as a bankruptcy court, (if it had jurisdiction) had at most concurrent jurisdiction with the state court, is unimportant.[1]

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[1] The Circuit Court of Appeals in *Central Hanover Bank & Trust Company* v. *Manhattan Company*, supra, apparently recognized that the accountings were not proceedings in the bankruptcy reorganization since it ruled that the District Court in its discretion need not take jurisdiction but might permit the accounting suits to be in another forum, the state court, which would not be the case if such accountings were proceedings in bankruptcy over which the bankruptcy court had exclusive non-delegable jurisdiction. The Court further recognized this in *Manufacturers Trust* v. *Kelby*, supra, when it stated that allowing the reorganization trustees to intervene in the accounting proceedings was a matter "for the discretion of the District Judge within the discretion vested in him by Rule 24(b)." If the accounting suits were part of the bankruptcy reorganization, the debtor's trustees would be the only necessary parties thereto and their substantive rights and duties to appear and participate therein would emanate from the Bankruptcy Act itself and would not be procedural ones predicated on dis-

(Footnote continued on next page)

In neither case is there any jurisdiction to enjoin the state court action in the absence of any *res* and interference with control of it.

A federal court does not have power to enjoin parties from prosecuting a suit in a state court merely because the claim in controversy has previously been adjudicated in a suit in the federal court to which they were parties, *much less where, as here, they were not parties to such suit.* Where the action first brought is *in personam* another action for the same cause in another jurisdiction is not precluded. Even when the first action is *in rem* or *quasi in rem* and the court still has possession and control of the *res* (as it does not here) it should not restrain another court from entertaining an action *in personam.*

Whether petitioner's suit in the state court and whether the accounting proceeding of Manhattan Company (the former trustee) in the federal court are *in personam* or *in rem* or *quasi in rem* depends on and can be resolved only by solution of the primary questions, that is: What are the rights against Manhattan Company of former and present bondholders of the debtor who were such when unauthorized surrenders of collateral occurred? What are the rights against Manhattan Company of present bondholders of the debtor who were not such when unauthorized surrenders of collateral occurred? Each of these questions is one of state property law.[2]

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cretion lodged in the District Judge by a rule of procedure extraneous to said Act. It seems clear when the debtor's trustees complied with the directions in the order directing them to assign, transfer and set over the trust funds to the new corporation, the bankruptcy court lost further jurisdiction over the trust funds. Section 70(i) of the Bankruptcy Act. *Bell* v. *Roberts,* 112 F. 2d 585, *Nassau Works* v. *Brightwood Co.,* 265 U. S. 271.

[2] The Circuit Court of Appeals intimated that there may be doubt as to whether *Erie* v. *Tompkins,* 304 U. S. 64, applies here (R. 963). It, however, decided in *Manufacturers Trust Company* v. *Kelby* that state law applies. Questions of this sort arising in cases in the Federal Courts were solved by reference to state law even before *Erie* v. *Tompkins. In re Prudence Company,* 2 Cir.,

In limine, it should be noted that petitioner's suit against Manhattan Company in the state court and the claims urged against it in its accounting proceeding in the District Court are not for the recapture of any property (trust *res*) which was pledged by the debtor with it as security for the payment of the debtor's bonds since Manhattan Company did not acquire any of such property to its own use, but are for damages[3] because it, without authority, released the lien it held for bondholders on some of such property by surrendering it to the owner, the debtor.

This court has spoken recently and forcefully upon the subject of interference by federal courts with suits in state courts. In *Toucey* v. *N. Y. Life Ins. Co.*, 314 U. S. 118, 132, Mr. Justice FRANKFURTER sums up an historical discussion in these words:

> 'Regardless of the various influences which shaped the enactment of §5 of the Act of March 2, 1793, the purpose and direction underlying the provision are

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82 F. 2d 775, where the court held that the trust agreements under which these Prudence Bonds were issued were New York contracts governed by New York law. *Vide Spindle* v. *Shreve*, 111 U. S. 542; *Pugh* v. *Frierson*, 6 Cir., 221 F. 513; *Mutual Life Insurance Co. of New York* v. *Johnson*, 293 U. S. 335; *Jones* v. *Third National Bank*, 8 Cir., 13 F. 2d 86; *Smith* v. *Bucyrus Co.*, 5 Cir., 31 F. 2d 514; *Allen* v. *Tate*, 8 Cir., 6 F. 2d 139, p. 140. State law would govern here even if *Swift* v. *Tyson*, 16 Pet. 1, in the language of Judge Frank (R. 965) "were still alive and kicking." Cf. *Philco Corp.* v. *Phillips Mfg. Co.*, 7 Cir., 133 F. 2d 663.

[3] That a bondholder who was such when an indenture trustee commits a breach of trust by releasing or surrendering to a debtor-mortgagor property pledged to secure the payment of the bonds has a right to sue the indenture trustee for his damages (*in personam*) because of such breach is well settled. *Hunsberger* v. *Guaranty Trust Co.*, 164 App. Div. 740, aff'd 218 N. Y. 742; *Margulies* v. *Manufacturers Trust Company*, 148 Misc. 564; *Savings Bank of New London* v. *New York Trust Company*, 27 N. Y. S. (2d) 963 (p. 973); *Benton* v. *Safe Deposit Bank*, 255 N. Y. 260; *Ansbacher* v. *New York Trust Company*, 280 N. Y. 79; *Bank of New York* v. *New Jersey Title Guarantee & Trust Co.*, 256 App. Div. 609; *James* v. *Cowing*, 82 N. Y. 449; *Rheem* v. *Allnut*, 64 F. 2d 549; *Young* v. *Howard*, 120 F. 2d 712; *Browning* v. *Fidelity Trust Company*, 250 Fed. 321, cer. den. 248 U. S. 564.

> manifest from its terms: proceedings in the state courts should be free from interference by federal injunction. The provision expresses on its face the duty of "hands off" by the federal courts in the use of the injunction to stay litigation in a state court.'

In a footnote the learned Justice says further that section 262 of the Judicial Code is derived from section 14 of the Judiciary Act of 1789 and that the general powers given in it to federal courts were obviously limited by the subsequent enactment of the specific prohibitory provisions of the Act of 1793.

The opinion in that case closes with these words of constraint:

> 'We must be scrupulous in our regard for the limits within which Congress has confined the authority of the courts of its own creation' (p. 141).

The *Toucey* case involved what are known as 'relitigation cases' and it was for the preservation of that basis of federal injunction that the dissenting justices stood as shown by their subsequent concurrence in *Southern Ry* v. *Painter,* 314 U. S. 155, 160, where there was no federal decree outstanding and therefore no question of relitigation.

These two cases, in the first of which federal judgments had determined the very issues sought to be litigated in the state courts between the same parties and in the second of which an earlier suit was pending in the federal court, plainly show the position of this court upon the subject.

Chicago v. *Fieldcrest Dairies,* 316 U. S. 168, is decisive. That was a suit in the district court to restrain the city and its officials from prohibiting the use by respondent of paper containers for the distribution of milk. It involved (1) the construction of an ordinance, (2) if applicable, whether the ordinance was in conflict with a state statute, (3) if applicable and valid under the state statute, whether the ordinance violated the Federal Constitution. A later suit had been brought in the state court by another cor-

poration, in which substantially the same issues were raised. It was held that the case should be held by the federal court to await the outcome of the later suit in the state court. Mr. Justice DOUGLAS disposed of arguments also presented here, as follows:

> 'As we said in the *Pullman* case, "The resources of equity are equal to an adjustment that will avoid the waste of a tentative decision" and any "needless friction with state policies." See p. 500 and cases cited; *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478, 483-484. It is an exercise of a "sound discretion, which guides the determination of courts of equity." *Beal* v. *Missouri Pacific R. Co., supra,* p. 50. In this case, that discretion calls for a remission of the parties to the state courts, which alone can give a definitive answer to the major questions posed. Plainly, they constitute the more appropriate forum for the trial of those issues. See 54 Harv. L. Rev. 1379. Considerations of delay, inconvenience, and cost to the parties, which have been urged upon us, do not call for a different result. For we are here concerned with the much larger issue as to the appropriate relationship between federal and state authorities functioning as a harmonious whole.
>
> The desirability of the course which we have suggested is not embarrassed by any question as to whether ready recourse may be had to the state courts. The availability of the state tribunal is obvious, since a case involving substantially identical issues and brought by respondent's parent corporation is pending in the state court. Cf. *Gilchrist* v. *Interborough Rapid Transit Co.*, 279 U. S. 159' (p. 172).

There is nothing novel in either the doctrine or the procedure approved in *Chicago* v. *Fieldcrest Dairies, supra.* In *Railroad Comm'n* v. *Pullman Co.*, 312 U. S. 496, 500, Mr. Justice FRANKFURTER said:

> 'In this situation a federal court of equity is asked to decide an issue by making a tentative answer which

> may be displaced tomorrow by a state adjudication. *Glenn* v. *Field Packing Co.*, 290 U. S. 177; *Lee* v. *Bickell*, 292 U. S. 415. The reign of law is hardly promoted if an unnecessary ruling of a federal court is thus supplanted by a controlling decision of a state court. The resources of equity are equal to an adjustment that will avoid the waste of a tentative decision as well as the fruition of a premature constitutional decision.'

In re 4145 Broadway Hotel Co., 124 F. 2d 891, the bankruptcy court restrained the prosecution in the state court of a libel suit against the trustees in reorganization, under section 77B, *and another defendant.* The Circuit Court of Appeals, Seventh Circuit, reversing called attention to the fact that plaintiff in the state court action did not seek to interfere with property in the custody of the bankruptcy court and that the restraining order was not necessary to effectuate any decree entered in the reorganization proceeding but that the action in the state court was an action in tort, brought against the trustees personally, *and plaintiff sought a judgment against the defendants personally for their wrongful acts.* This decision was based upon *Toucey* v. *New York Life Ins. Co., supra.*

> See also *Denver-Greeley Valley Water Users Ass'n* v. *McNeil*, 10 Cir., 131 F. 2d 67; *Armstrong* v. *Alliance Trust Co.*, 5 Cir., 126 F. 2d 164; *Empire Trust Co.* v. *Brooks*, 5 Cir., 232 F. 641; *McClellan* v. *Carland*, 8 Cir., 187 F. 915; *Boynton* v. *Moffat*, 10 Cir., 57 F. 2d 772, with all of which decisions the decision under review is in conflict.

In *Firemen's Fund Ins. Co.* v. *Crandall Horse Co.*, 47 F. Supp. 82, the Court analyzes the cases upon which petitioner relies and draws from them the same conclusion.

The powers of a bankruptcy court are defined by this Court in *Toucey* v. *N. Y. Life Ins. Co., supra.*

At page 132, immediately after his summation of the rule of 'hands off' which we have quoted, Mr. Justice FRANKFURTER takes up the exceptions to it and says:

> '*Second.* The language of the Act of 1793 was unqualified: " * * * nor shall a writ of injunction be granted to stay proceedings in any court of a state * * * " 1 Stat. 335. In the course of one hundred and fifty years, Congress has made few withdrawals from this sweeping prohibition:
>
> (1) *Bankruptcy proceedings.* This is the only legislative exception which has been incorporated directly into §265: " * * * except in cases where such injunction may be authorized by any law relating to proceedings in bankruptcy." 36 Stat. 1162. This provision, based upon §21 of the Bankruptcy Act of 1867, 14 Stat. 526, was inserted in the Act of 1793 by the Revisers, R.S. §720; see Proposed Draft of Revision of U. S. Statutes (1872), vol. 1, p. 418.'

Section 21 of the Bankruptcy Act of 1867 related exclusively to suits against the bankrupt based on debts or claims provable and dischargeable under the Act in the bankruptcy.

This section has been carried over into the present Bankruptcy Act as Section 11(a), U. S. C. A. §29. It provides a suit which is founded upon a claim from which a discharge would be a release and which is pending against a person at the time of the filing of a petition against him shall be stayed until after an adjudication or the dismissal of the petition. Clearly it does not cover the present application of these petitioners.

Section 116 of the Bankruptcy Act, U. S. C. A. §516, provides in subdivision 4 that the judge may:

> 'in addition to the relief provided by section 11[4] of this title, enjoin or stay until final decree the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor.'

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[4] U. S. C. A. § 29.

Clearly this section does not cover the present application since no suit has been commenced against the debtor or its trustee and there has been no act or proceeding to enforce a lien upon the property of the debtor.

Authority for an injunction in the case now here must be found if at all in section 2(15) of the Bankruptcy Act, U. S. C. A. §11, as an exception to the general rule laid down in section 265 of the Judicial Code.

Section 2(15) empowers the court to 'make such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this title'.

The power vested by section 2(15) and 'within which Congress has confined the authority of the courts of its own creation' is dependent upon possession and need for protection of a *res*. This, under the rule in the *Toucey* case, *supra*, at page 139, is the only 'exception' which has been imbedded in section 265 by judicial construction.

Even in bankruptcy a federal court is prohibited by section 265 of the Judicial Code from staying an action in a state court unless it falls within sections 11a or 116 of the Bankruptcy Act, *supra*, or comes within the *res* cases.

We are therefore brought to a consideration whether the present application is within those cases. As stated by Mr. Justice FRANKFURTER in the *Toucey* case, 'the fact that one exception has found its way into §265 is no justification for making another'.

Describing the *res* cases this Court said in *Kline* v. *Burke Construction Co.*, 260 U. S. 226, 235:

> 'The rule, therefore, that the court first acquiring jurisdiction shall proceed without interference from a court of the other jurisdiction is a rule of right and of law based upon necessity, and where the necessity, actual or potential, does not exist, the rule does not apply. Since that necessity does exist in actions in *rem* and does not exist in actions in *personam*, involving a question of personal liability only, the rule applies in the former but does not apply in the latter' (p. 235).

This interprets the condition precedent found in section 2(15) of the Bankruptcy Act where it is provided that such orders, process and judgments may be made 'as may be necessary for the enforcement of the provisions of this title.' The touchstone is necessity.

In re 4145 Broadway Hotel Co., supra.

Petitioner, as trustee of a testamentary trust, barred by the decision in *Manufacturers Trust Co.* v. *Kelby* from any way of enforcing the rights which it asserts in the bankruptcy, has brought an action for a money judgment, which is an action *in personam,* against Manhattan Company in its individual capacity.

Under the decisions of this Court, even if Brooklyn Trust Company individually was a bondholder when the acts complained of occurred and sold its bond prior to the debtor's reorganization, and as such was the plaintiff in the state court, the court would have had no power or jurisdiction to enjoin its suit.

In New York an action that is *in rem* or *quasi in rem* is defined by statute. Under subdivision 6 of Section 232 of the Civil Practice Act (Laws 1920, Chapter 925 as amended), an action *in rem* or *quasi in rem* is one "where the complaint demands judgment that the defendant be excluded from a vested or contingent interest in or lien upon *specific real or personal property* within the state; or that such an interest or lien in favor of either party be enforced, regulated, defined or limited; or otherwise affecting the title to *such property*" (emphasis supplied).

An action *in rem* or *quasi in rem* in New York is one which has for its object *specific property* in this State. The result of such an action is a judgment which operates upon the *specific property* and which has no element of personal claim or personal liability. On the contrary a common law

action for a money judgment has no specific subject matter and is, therefore, one *in personam.*

> *Hanna* v. *Stedman,* 230 N. Y. 326; *Carmody, New York Practice,* Vol. II, Sections 725, 726, 727; *Restatement of the Law of Judgments,* Chapter 1; Chapter 2, Section 32; Chapter 3, Sections 73 and 75; *Vide, Pennoyer* v. *Neff,* 95 U. S. 715; *Gorham Co.* v. *United E. & C. Co.,* 202 N. Y. 342, 348-349.

Petitioner is seeking a money judgment the effect of which will be to impose a personal liability upon Manhattan Company to pay it and upon which execution can be levied only against the *individual* assets of Manhattan Company and will not be enforced by execution out of any trust property or any other specific property, and thus *pro tanto* deplete the same. A judgment in petitioner's favor will not deal with any *res* and order its distribution.

The fact that it may be necessary for the state court to determine whether petitioner has a cause of action against Manhattan Company before it can award damages to it does not change its action *in personam* into one *in rem.* Even if petitioner's suit in the state court did not seek damages but were solely one for a declaratory judgment, i. e., whether it had a cause of action against Manhattan Company, it would be one *in personam.* (Cf. *Commonwealth Co.* v. *Bradford,* 297 U. S. 613). The state court does not seek to take any *res* into its custody. There is here no *res* susceptible of custody by any court.

Nor may any sum recovered by petitioner from Manhattan Company individually be brought into the reorganization for two reasons: First, because it is a *sine qua non* of recovery that its cause of action did not pass by assignment to present bondholders, and second, because the debtor has no property interest in such recovery.

Since the judgment sought in the accounting proceeding in the District Court is for the recovery of money damages from Manhattan Company it is *in personam.* Petitioner's suit in the state court is likewise *in personam* and neither

suit is *in rem* or *quasi in rem* because in neither case is the Court or its officer in any way in possession or control of any *specific property* which is the subject matter of the suit, which is a *sine qua non* to a *rem* or *quasi in rem* suit. There is here no *res* to which the jurisdiction of the District Court did or can attach and, therefore, no basis for the injunction.

The Circuit Court held in *Manufacturers Trust Company* v. *Kelby* and in the present case that the agreements securing the bonds made between the debtor and the corporate trustees created express trusts of which the bondholders were *cestui que trust.*

Assuming, as we must, therefore, that the rights of the bondholders are akin to those of such *cestuis que trust,* the rights of petitioner and all the other bondholders of the debtor against the former trustees who were such when such unauthorized acts on their part occurred are, in New York, individual ones *in personam* calling for the payment of damages and are not rights *in rem* or *quasi in rem* and they consequently cannot be made the basis of derivative suits on behalf of present bondholders' collateral against the trustees.[5]

Since Manhattan Company not only has no *res* or substitute in its hands, and never appropriated any *res* to

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[5] This was conceded by the bondholder Eddy who was an appellee on the appeal in the Circuit Court of Appeals. He stated (p. 14 of his brief): "The objections interposed do not seek to trace any part of the trust *res* into the hands of third parties and the recovery for the specific *res* parted with, but to surcharge the trustee for the misapplication and depletion of the trust fund. A decree sustaining the objections and surcharging the trustee could only be a decree *in personam.* 17 Columbia Law Review, 467; 17 Columbia Law Review, 269; *Fur & Wool Trading Co., Ltd.* v. *Fox, Inc.,* 245 N. Y. 215 at 219."

That a derivative suit *in rem* to impress a constructive trust of any property released to the debtor by a former trustee and for its recapture could have been brought by a bondholder against the debtor while it had such withdrawn property if the trustee failed to bring an action for its restoration after demand, is beside the point. Cf. *O'Bierne* v. *Allegheny & K. R. R. Company,* 151 N. Y. 372.

its own use, the right and remedy of petitioner against it at all times was and still is one *in personam* for damages. Neither petitioner nor its decedent or any other bondholder similarly situated or any present bondholder, or anyone on his behalf, had or has the right to maintain a derivative suit *in rem* or *quasi in rem* against Manhattan Company which such suit would lie only for the recapture from it of the *res* or its substitute, none of which it has.[6]

Every argument in the opinion of the Circuit Court of Appeals for sustaining the injunction is either *ad hominem* or is in conflict with New York law and the decisions of this Court. The gist of the Court's argument is found (R. 965) where it refers to the power of a court in a first suit to restrain the proceeding in a second suit. The statements, like others in the opinion, arbitrarily assume the applicable substantive law to be the opposite to what it actually is. The injunction can be justified only by completely ignoring New York law and the decisions of this Court, and by depriving petitioner of its property without due process.

The attempt of the Court to create a *res* with the administration of which the state action may be said to interfere for the purpose of sustaining the injunction, upon the assumption that Manhattan Company is to be deemed to be or treated as if it had in its possession some of the

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[6] *Fur and Wool Trading Co., Ltd.* v. *Fox, Inc.*, 245 N. Y. 215, 219; *Madison Trust Co.* v. *Carnegie Trust Co.*, 167 App. Div. 4, aff'd 215 N. Y. 475; *In re Sommers Estate*, 12 N. Y. S. 2d 47; *In re Petrosemolo*, 152 Misc. 419, 421; *Matter of Sullivan*, 177 Misc. 570, at pages 572-574, aff'd 289 N. Y. 323; *Matter of Ellensohn*, 258 App. Div. 891; *Matter of Dempsey*, 259 App. Div. 1083; *Mulligan* v. *Amo*, 211 App. Div. 498; *Agne* v. *Schwab*, 123 App. Div. 746; *Noll* v. *Smith*, 250 App. Div. 453; *Ostrander* v. *Ostrander*, 194 App. Div. 1, aff'd 233 N. Y. 582; *Mullin* v. *Mullin*, 119 App. Div. 521; *Oliver* v. *Piatt*, 3 How. 333; 43 U. S. 333; 11 L. Ed. 622; *United States* v. *Dunn*, 268 U. S. 121; *Schuyler* v. *Littlefield*, 232 U. S. 707; *May* v. *Leclaire*, 11 Wall. 217; *Smith* v. *Vodges*, 92 U. S. 183; "The Nature of the Rights of the Cestui que trust," 17 Col. L. R. 476 (Dean Stone); Scott on Trusts, Sections 202, 524(4); Restatement of the Law of Restitution, Sections 190 to 196, 215; Restatement of the Law of Trusts, Section 202.

debtor's property, is not only in conflict with all of the above cited authorities but is the merest fiction, the finding not of a *res* but of a *nominis umbra.* It is "a subtlety which does not merit judicial adoption." Such assumption is tantamount to a preposterous assertion that title to *all of the assets of Manhattan Company* is and has since the acts occurred been held by it as a constructive trustee out of which to satisfy any judgment against it either in petitioner's state court action or in the accounting proceeding. There should have been no temptation to indulge in legal fiction such as there might conceivably be if a judgment in the state court action would imperil the financial ability of Manhattan Company to comply with any judgment in the accounting proceeding.[7]

The Court to sustain its fictional *res,* in view of the fact that Manhattan Company has no collateral of the debtor and since petitioner does not seek to recover either ownership of or possession of any collateral, has resorted to a suppositional state of facts wherein a corporate trustee recognizing a liability for its acts puts its own promissory

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[7] The bankruptcy court cannot constitutionally deprive petitioner and former bondholders similarly situated of their property rights to damages upon some equitable theory of constructive trust the effect of which is to take away their respective causes of action and transfer them to the debtor's collateral and thereby make it a part of the *res* over which that court had jurisdiction. Nor is there any equitable doctrine under which a constructive trust can be imposed on a recovery by petitioner and bondholders similarly situated in favor of assignees are intimated by the Circuit Court of Appeals (R. 973). Petitioner, like thousands of other Prudence bondholders, sold its bond at a loss and it may therefore recover from Manhattan Company damages which, when added to that realized on the sale, will probably be less than that originally paid for the bond but certainly not in excess thereof. The element of unjust enrichment necessary for the imposition of a constructive trust is wholy lacking. Contra it is more than likely that the present holder of this bond or his ultimate assignee will receive on the Circuit Court of Appeals' theory more than he paid for the bond and thereby be unjustly enriched, and this applies equally as well to thousands of present and future bondholders who were not such when the acts occurred and who acquired, or who hereafter acquire, such bonds which are still traded in by purchase.

note for the amount of such liability into the trust fund (R. 971). The resort to such a case, which wholly begs the question by presupposing a derivative suit for restoration lies contrary to New York law, shows the utter weakness of the ruling of the Court. As HUGHES, Ch. J., said in *Santa Cruz Co.* v. *Labor Board,* 303 U. S. 453, at page 467:

> "* * * what is reasonably clear in a particular application is not to be overborne by the simple and familiar dialectic of suggesting doubtful and extreme cases."

The error of the Circuit Court of Appeals in sustaining the injunction is best illustrated by the decisions upon which it relied.

Steelman v. *All Continent Co.,* 301 U. S. 278 (R. 985) involved the power of the bankruptcy court to enjoin the prosecution of a suit in another federal court directly affecting the debtor's property. Fox had been adjudicated a bankrupt in the district court in New Jersey and an order made for the examination of All Continent Corporation. As a result of this examination All Continent, which was a family corporation created by the bankrupt and to which he had transferred a substantial part of his assets, being all its capital, was ordered to deliver its books and papers to the trustee in bankruptcy. The stock of All Continent stood in the name of the bankrupt who had absolute control and there was evidence of transfers of property on the eve of bankruptcy.

At this point All Continent began a suit in the district court in Pennsylvania against a firm of stock brokers, a corporation called Capital Company and the trustee in bankruptcy to remove an alleged cloud on the title to stock held by the brokers in its name.

Capital Company had obtained a judgment against Fox in New York prior to the adjudication in bankruptcy and had served a third party subpoena in supplementary proceedings on the brokers to establish Fox's interest in the stock which they held in the name of All Continent.

Mr. Justice CARDOZO said at the beginning of his opinion:

> 'The question is one as to the power of a court of bankruptcy, in the situation developed in the record, to enjoin the prosecution of a suit in another federal court upon the ground that the suit, if pressed to a decree may thwart an inquiry into frauds charged against the bankrupt, or make relief against them difficult.' (p. 279).

Later the opinion continued:

> 'All Continent Corporation, if there is truth in the charges made by the trustee, is a party to a conspiracy to cover up the bankrupt's assets and keep them from his creditors. In that view of the facts, the suit in Pennsylvania will be a step in fulfilling the conspiracy, and may even crown it with success. The inquiry into the fraud, an inquiry going forward in orderly fashion under the supervision of the court of bankruptcy, will be transferred to another jurisdiction, with the supposed fraudulent grantee *as dominus litis.*' (p. 285).

It will be seen from the opinion (pp. 285, 286) that the Court placed great emphasis upon embarrassment in the orderly administration of the bankrupt's estate or even failure through successful fraud to determine his assets caused by the suit in Pennsylvania at the inception of the proceedings. The gist of the decision is found in these words:

> 'For reasons already indicated there was probable cause for the belief that the suit in Pennsylvania would be a step in the execution of a fraudulent conspiracy, impeding and perhaps frustrating the administration of the assets. There was probable cause for the belief that only through a suit upon the lines of the one in the New Jersey Chancery could the danger of obstruction be averted and the estate be kept intact until the entry of a decree adjudging the guilt or innocence of the putative conspirators. Whether they are innocent or guilty is a question not before us now. The data for the formation of any opinion on the sub-

> ject have not yet been supplied. At present our inquiry halts with the discovery of probable cause for preserving the estate from dismemberment or waste through a precipitate decision. If such cause has been made out, we think the court of bankruptcy has been armed with abundant power to preserve the *status quo* until there can be an adequate trial with all the necessary parties and a judgment on the merits.' (p. 288).

Finally it was said:

> 'Jurisdiction to administer the estate draws to itself, when once it has attached, an incidental or ancillary jurisdiction to give protection to the estate against waste or disintegration while frauds upon its integrity are in process of discovery.' (p. 289).

The decision in this case is far wide of the question now here.

Alexander v. *Hillman,* 296 U. S. 222, cited by the Court after its statement (R. 943),

> "The exercise of the Court's power to compel such an old trustee to restore trust assets, lost by its negligent conduct, concerns the res itself and is, therefore quasi in rem."

not only does not support its erroneous assertion but *contra* is authority for petitioner's claim. There the suit was by a receiver of a corporation against fiduciaries who were its officers and directors, *for dereliction in fraudulently misappropriating assets of the corporation and who still withheld the same.* This was a plain case of a suit in *rem* for the declaration of a constructive trust of such misappropriated property in the hands of the wrongdoers and directing restoration thereof to the receiver, and comes within the authorities cited on page 26 hereof.

Mandeville v. *Canterbury,* 63 S. Ct. 472, is authority in petitioner's favor. There this Court reversed an order of the Circuit Court of Appeals, Seventh Circuit, restraining

defendants from prosecuting an action in the state court which, like petitioner's suit here, was *in personam.*

Princess Lida v. *Thompson,* 305 U. S. 456 (R. 969), deals with rights under Pennsylvania law and is not apposite for various other reasons.

In the *Princess Lida* case, the accounting proceeding was by trustees of an *inter vivos* continuing trust, the proceeding and estate were by statute subject to the exclusive jurisdiction of the state court and the estate was to be continued by the trustees for further administration in accordance with the terms of the trust and the decree of the court. There the state court had jurisdiction over all of the interested parties and since the rights of all of them under state law could be adjudicated by that court in that proceeding, it was improper for two of the parties to that proceeding to seek relief in the federal court. In our case the trust terminated pursuant to the plan of reorganization; the former trustee is no longer acting as such and prior to its accounting turned over all of the pledged property it held. In our case former bondholders who sold their bonds prior to the date of the approval of the debtor's reorganization petition were neither parties to the reorganization nor to the accounting proceeding in the federal court which never obtained any jurisdiction over them. In the Pennsylvania case only the same parties were affected by both proceedings. In our case such former bondholders are not creditors of the debtor or beneficiaries of any trust being accounted for. Our case is not one where a creditor of the debtor who was a bondholder at the time of the reorganization and over whom the bankruptcy court had jurisdiction and who was a party to the accounting proceeding, seeks relief against the accounting trustee in another court.

The possibility that a decision in the state court will conflict with the decision of the Circuit Court of Appeals in *Manufacturers Trust Company* v. *Kelby*, affords no basis for upholding the injunction.

The Circuit Court of Appeals rendered its decision in *Manufacturers Trust* v. *Kelby* on February 3, 1942. On March 9, 1942, the Supreme Court of the State of New York, Special Term, New York County, rendered its decision in *Emmerich* v. *Central Hanover Bank & Trust Co.*, 34 N. Y. S. (2d) 166 (not otherwise reported). It was there held upon motion to dismiss the complaint that a bondholder cannot recover for breaches of trust against an indenture trustee, which consisted, as the breaches here, of unauthorized releases or surrenders of mortgaged property to the debtor-mortgagor, which were committed prior to his acquisition of bonds, in the absence of an assignment to him of the causes of action by the person who owned the bonds at the time of such breaches.

The order dismissing the complaint was unanimously affirmed by the Appellate Division, First Department, without opinion, on October 10, 1942, in 265 App. Div. 808 (Mem.).

Examination of appellant's brief at the Appellate Division shows that its counsel not only directed the attention of the court to the decision of the Circuit Court of Appeals in *Manufacturers Trust Company* v. *Kelby* as stating the law of New York but that it was the only case upon which he relied.[7]

It is difficult to conceive how the decision in *Manufacturers Trust Company* v. *Kelby* could have been more dis-

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[7] Counsel stated in his brief:

> 'The question now presented is whether the holder of a bond has any standing to complain of a surrender of part of the trust res wrongfully made before he became a bondholder. It is submitted that none of the cases cited by the defendant in the brief it submitted, below, and none of the cases cited by the learned Special Term passes on this point. The only reported case which can be found directly in point is *Manu-*

tinctly presented to the state court. Leave to appeal to the Court of Appeals was recently granted by that court.

Here is an authoritative decision of a state intermediate appellate court of the precise question presented in *Manufacturers Trust Company* case rendered after the decision of the Circuit Court of Appeals in that case. The Circuit Court of Appeals under the decisions of this court should have overruled its decision in *Manufacturers Trust Company* v. *Kelby* instead of affirming it, as it did in *In re Prospect Avenue Holding Corp.*, 105 F. 2d 960, and reversed the injunction order.

> *Vandenbark* v. *Owens-Illinois Co.*, 311 U. S. 538; *Chase Corp.* v. *Vogel*, 312 U. S. 666.

It is significant that no claim has been made by the Circuit Court of Appeals that if the state court should adjudicate that when a former bondholder of the debtor sold his bond his cause of action against the trustee passed with it that such adjudication would be an interference with the jurisdiction of the federal court. The Court's claim of interference is not because of a continuance of the state court action or *any* adjudication that might be made by it but because of a probable adjudication in line with the decision in the *Emmerich* case and contrary to its decision in *Manufacturers Trust Company* v. *Kelby*, as reiterated in its decision here. It is true that an adjudication by the state court that petitioner has a cause of action would be a declaration of state law which the federal court would be constrained to follow, as this Court has repeatedly

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facturers Trust Co. v. *Kelby, et al.* 125 Fed. 2d, 650, certiorari denied by U. S. Supreme Court [No. 1196, October Term, 1941, (decided, 1942) not yet officially reported]. In view of the fact that that case discussed the line of citations of authority urged by defendant, below, and also specifically differentiated the cases cited by the learned Special Term in its opinion, we are content to rest upon the applicable portion of the opinion of the Circuit Court of Appeals (quoted, post) as our brief upon this subject.' (p. 16, App. Brief).

ordained. Since this is a matter of constitutional limitation of powers of federal courts it is not interference but proper constraint.

If the state court follows the decision in the *Emmerich* case, which the Circuit Court of Appeals made no attempt to distinguish, petitioner will not thereby become a creditor of the debtor or acquire any right against any *res* even if such were to be deemed in possession and control of the bankruptcy court. The result of such a determination will be merely to define, as in an action for a declaratory judgment which is not one *in rem*, the parties who may sue Manhattan Company for such acts, to wit, the bondholders who were such when the unauthorized acts occurred, some of whom still are bondholders and some of whom no longer are, and to award to petitioner whatever damage it is entitled to from Manhattan Company.

II

The decision of the Circuit Court of Appeals is in conflict with its own prior decisions in the following cases: *In re Commonwealth Bond Corporation*, 77 F. 2d 308; *In re Adolph Goebel*, 80 F. 2d 849; *In re Prudence-Bonds Corporation*, 79 F. 2d 212.

In these cases the Court correctly held that when the state court suit does not touch the debtor's property and is not moved by one of its creditors, the suitor should not be impeded—that under Section 2(15) of the Bankruptcy Act the power granted to issue such injunctions as may be necessary for the enforcement of the provisions of the Act is limited to cases in which the property of the bankrupt is directly affected; that this limitation is also applicable to proceedings under Section 77B. Petitioner is not a creditor of the debtor and its suit does not affect any property of the debtor. *Vide* also *Bryant* v. *Atlantic Coast Line R. Co.*, 92 F. 2d 569; *In re Ambassador Hotel Corp.*, 124 F. 2d 435.

III

The process pursuant to which the proceeding was instituted against petitioner is insufficient.

Whether the bankruptcy court acquired jurisdiction over petitioner who, like former bondholders similarly situated, was not a party to the reorganization or accounting proceeding, by service of an order to show cause in a summary proceeding, depends upon whether petitioner is asserting any claim in the state action to property in the hands of Manhattan Company which belongs to the debtor. The complaint in the state action (R. 241, *et seq.*) determines that question. The Manhattan Company has delivered all the collateral held by it to the new trustee (R. 258); consequently, no turn-over order can lie against it.

> *In re Prospect Avenue Holding Corp.*, 2 Cir., 118 F. 2d 453; *Oriel* v. *Russell*, 278 U. S. 358; *Sheehan* v. *Hunter*, 8 Cir., 133 F. 2d 303.

In the absence of possession by Manhattan Company of any of the collateral and since petitioner does not seek to recover any part of such collateral, or any possession or control thereof, it is not an adverse claimant. Had petitioner been allowed to prosecute its action to execution, the bankruptcy court could not compel it by summary proceedings to pay over the sum recovered from Manhattan Company to the debtor's estate under any of the authorities. It is equally plain it had no power to restrain the prosecution of the action by summary process. The fact that Brooklyn Trust Company, the former trustee of the debtor's eighth series bonds, may conceivably not be in a position to object to the jurisdiction of the federal court over its accounting proceeding because it did not contest the order of the District Court directing it to account as trustee of such series, is no more justification for restraining the Coffin Estate, of which it is trustee, than it would be for restrain-

ing any one of the numerous former bondholders similarly situated from bringing a similar suit in the state court.

In re Prospect Avenue Holding Corp., supra, the Circuit Court of Appeals refused a turn-over order because the petitioner did not seek the possession of specific property or even the proceeds derived from the sale thereof but damages for its unlawful conversion and held that summary proceedings are inappropriate for suits not relating to recapture or preservation of the bankrupt's estate. The language in the opinion of SWAN, Circuit Judge, at page 455, is particularly applicable here. Here, as there, the debtor's trustees and other parties in the Manhattan Company accounting proceeding are not seeking to collect and bring into court some part of the bankrupt's estate *but are seeking to recover damages for wrongful acts which prevented the debtor's trustees from bringing into the estate property disposed of.*

Moreover, while the action in the state court is not a representative suit in a technical sense, the ultimate decision in it will govern the rights of all former bondholders against the various corporate trustees of the debtor's eighteen bond issues. Such former bondholders are a substantial class of absent parties to the accounting proceedings and over whom the federal court has no jurisdiction. (Cf. *Hansberry* v. *Lee,* 311 U. S. 32.) This question should not be determined upon an order to show cause served upon the testamentary trustee of one of thousands of former bondholders on a motion for injunction. Due regard for the protection of these former bondholders' rights, which due process exacts, requires that they have their rights against the former trustees defined in the state court.

IV

The construction placed by the Circuit Court of Appeals on Section 262 of the Judicial Code and Section 265 limiting it and the sections of the Bankruptcy Act upon which such jurisdiction must be based, violates the "due process" provision of Article V of the Articles in addition to, and amendment of, the Constitution of the United States of America.

While the injunction against petitioner is not perpetual it is far from temporary. It will not end when the accounting suit of Manhattan Company has been finally concluded although the rights of all who are parties to such suit will then have been resolved and terminated and although petitioner's suit is against Manhattan Company alone and not against any of the other accounting trustees, but will continue thereafter until the accountings of *all* of the other trustees have been finally concluded (R. 32). That an injunction against a suit need not be permanent to deprive a suitor of its property without due process is obvious. Moreover, since the state court suit is pending only as to the defendants Manhattan Company and Prudence-Bonds Corporation, the successor to the debtor which withdrew the collateral, and is not pending as to the bondholders Eddy and Reese, the effect of the injunction restraining the suit in so far as said Eddy and Reese are concerned is the same as an injunction which restrains the bringing of a future action against certain parties. Having no jurisdiction to grant a permanent injunction, the Court "in view of the decisions" had no power to restrain at all. It had no power to grant an injunction the effect of which was to oust the state court[8] even temporarily of a power found to reside in it alone by this court.

In *Chicago* v. *Fieldcrest Dairies, supra,* this Court said:

> 'The delicacy of that issue and an appropriate regard "for the rightful independence of state gov-

[8] *Hill* v. *Martin,* 296 U. S. p. 403.

> ernments'' (*Beal* v. *Missouri Pacific R. Co.*, 312 U. S. 45, 50) reëmphasize that it is a wise and permissible policy for the federal chancellor to stay his hand in absence of an authoritative and controlling determination by the state tribunals'. (p. 172).

Petitioner is entitled under the decisions cited to establish the law of New York in the place where this Court has definitely held the Fifth Amendment requires it to be established. Either it has a cause of action against Manhattan Company or it has not. It has a right under the Federal Constitution to have the issue determined in the state court. The vindication of that right, so guaranteed, cannot be impeded upon any reasoning of the Circuit Court of Appeals.

CONCLUSION

The petition for a writ of certiorari should be granted.

Dated, Brooklyn, N. Y.,
May 6, 1943.

JACKSON A. DYKMAN,
RALPH W. CROLLY,
Counsel for Petitioner.

Office - Supreme Court, U. S.
FILED
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IN THE

Supreme Court of the United States

October Term 1942
No. 1008

BROOKLYN TRUST COMPANY, as Trustee of a trust created in and by the Will of SUSANNA E. COFFIN, deceased,

Petitioner,

—against—

CHARLES H. KELBY and CLIFFORD S. KELSEY, as Trustees of the Debtor; PRUDENCE BONDS CORPORATION (New Corporation); GEORGE E. EDDY; HILDA S. REESE; and President and Directors of the Manhattan Company,

Respondents.

BRIEF FOR RESPONDENT GEORGE E. EDDY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

SAMUEL SILBIGER,
Counsel for Respondent,
George E. Eddy.

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IN THE

Supreme Court of the United States

October Term 1942

No. 1008

BROOKLYN TRUST COMPANY, as Trustee of a trust created in and by the Will of SUSANNA E. COFFIN, deceased,

Petitioner,

—against—

CHARLES H. KELBY and CLIFFORD S. KELSEY, as Trustees of the Debtor; PRUDENCE BONDS CORPORATION (New Corporation); GEORGE E. EDDY; HILDA S. REESE; and President and Directors of the Manhattan Company,

Respondents.

BRIEF FOR RESPONDENT GEORGE E. EDDY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Opinions Below.

The opinion of the District Court (R. 278) is not reported. The opinion of the Circuit Court of Appeals is reported in 134 F. 2d 105.

Jurisdiction.

The opinion of the Circuit Court of Appeals was rendered February 16, 1943, and the order for the mandate thereon was entered March 7, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13th, 1925 (U. S. Code Title 28, Sec. 347).

Questions Presented.

1. Where pursuant to the confirmed plan of reorganization of a corporation debtor, the Trustee under a trust agreement securing an issue of corporate bonds has been superseded by a successor trustee, and incidental thereto the superseded trustee was directed to and filed in the District Court an accounting of its proceedings and acts under the trust agreement and petitioned for a judicial settlement of its account, pending such accounting proceeding, has the District Court the power to enjoin petitioner, a former bondholder who sold its bond prior to the reorganization, from prosecuting an action against the accounting trustee and present bondholders, predicated upon alleged violations of the trust agreement by such trustee and the corporate debtor?

2. Is Section 265 of the Judicial Code (28 U. S. C. 379) applicable to the situation in this case, and a bar to the issuance of the injunction by the District Court?

Statement.

Contrary to the allegations in the complaint in the action in the State Court (R. 263-264) and Petitioner's statement of fact (p. 9) respondent asserts that the petitioner herein with respect to its asserted claim was a party to the reorganization proceeding of Prudence Bonds Corporation, Debtor (R. 14) and to the proceeding for the judicial settlement of the accounts of respondent President and Directors of the Manhattan Company (R. 19).

I.

The law of New York State was properly applied by the Court below.

The petitioner, Brooklyn Trust Company, as testamentary trustee under the Will of Susanna E. Coffin was a party to the reorganization proceeding of Prudence Bonds Corporation, inasmuch as such proceeding resolved the rights of all creditors having claims arising under the Eighteen Series of corporate bonds issued by the debtor and each secured by a "trust fund" transferred to a corporate trustee under the specific terms of a trust indenture. Petitioner was the holder of a $1,000 bond, which it sold prior to the commencement of the reorganization proceeding, and for that reason now asserts that it was not a "creditor" of the debtor and therefore that it was not a party to the reorganization proceeding. This contention is untenable.

Petitioner instituted an action in the State Court against President and Directors of the Manhattan Company based upon allegations that said Company as trustee of the 5th Series of the Debtor's bonds "allowed the Debtor to withdraw cash and mortgages not in default while other mortgages were in default, in violation of the trust agreement to the damage and injury of * * * plaintiff" (Pet. 9).

Whether the action in the State Court be termed as one for breach of contract, or for a tort arising out of the contract, the alleged breach consisted of an act committed by the corporate trustee and the debtor jointly, and any alleged claim or claims that petitioner had, it possessed not only against the corporate trustee but also against the debtor in the reorganization proceeding. Therefore, petitioner, though not a bondholder at the time in June, 1934, when the petition for reorganization of Prudence Bonds Corporation was filed, nevertheless possessed a claim against the debtor which constituted it a "creditor" within the definition

of that term under Sec. 77B(b) of the Bankruptcy Act.* The petitioner consequently was a party to the reorganization proceeding, and insofar as petitioner's application for the writ herein is based on the assertion that it was not a creditor of the debtor or a party to the reorganization proceeding such application is without merit.

As petitioner was a party to the reorganization proceeding and to the controversy arising out of the accounting by the corporate trustee and the objections thereto filed on behalf of bondholders, whereby the bondholders seek a restoration of the trust funds improperly withdrawn, or a decree surcharging the accounting trustee for the equivalent thereof, it becomes necessary to analyze the rights and remedies of the bondholders under the law of the State of New York as a basis for the determination of the question whether the district court properly applied that law to the instant case.

Where a trustee under a corporate bond trust indenture or agreement commits acts of misfeasance or malfeasance resulting in a depletion of the trust funds, prior to the maturity of the bonds secured thereby,

(1) A bondholder could postpone any action for the misconduct of the trustee and await the maturity of his bond—whereupon, if his bond were paid in full—he would have no cause to complain. If at maturity there was a default, it would then become the duty of the trustee to liquidate the security, file its account and apply for a decree for a distribution of the proceeds of the collateral ratably among those entitled to share therein. Such an account would be with a view to a termination of the trust and the distribution of

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* Sec. 77B(b). * * * "The term 'creditors' shall include for all purposes of this section and of the reorganization plan, its acceptance and confirmation, all holders of claims of whatever character against the debtor or its property * * * The term 'claims' includes debts, securities, other than stock, liens, or other interests of whatever character."

the trust funds to the beneficiaries. Such type of right and remedy of a bondholder is not applicable to the facts in this case.

(2) A bondholder, in lieu of waiting until the maturity of his bond, upon learning of the trustee's misconduct, and prior to the maturity of his bond, could commence an equitable proceeding for the removal of the trustee, the appointment of a successor trustee, and for an interlocutory decree directing the removed trustee to render its account. The right to file objections or exceptions to such account, with the object of surcharging the removed trustee for any losses sustained, resides solely in the successor trustee, not in the bondholders, and only in case the new trustee refuses or fails to act, does the derivative right vest in a bondholder to object and except to the account in his own behalf and on behalf of all bondholders. This right and remedy pertains to every case where a corporate trustee resigns, or is removed for cause, or for any other reason such as in the case at bar pursuant to a plan of reorganization of the corporation which issued the bonds. In all these cases where the original trustee is removed prior to the termination of the trust and prior to the maturity of the bonds, and its account is incidental to turning over the trust *res* to the successor trustee, the derivative right of a bondholder to object or except to the account is coextensive with the right vested in but not exercised by the successor trustee. The successor trustee could only act as the holder of the legal claim in behalf of the trust fund and for the interest of all bondholders, and under the derivative right asserted by a bondholder the right is not personal, but representative, and can only be asserted in behalf of the bondholders as a class.

This derivative and representative right was considered and the New York Law applied thereto by the Circuit Court below in *Central Hanover Bank & Trust Co.* v. *President and*

Directors of the Manhattan Company, 105 F. (2d) 130; *Manufacturers Trust Co.* v. *Kelby,* 125 F. (2d) 650 (Cert. denied 316 U. S. 697); and in the instant case wherein petitioner seeks a writ of certiorari.

The corporate trustees contended in these cases that the established law of New York State was contrary to the law as it was applied by the Circuit Court. In the case of *Central Hanover Bank & Trust Company, supra,* and *The Manufacturers Trust Co.* case *supra,* the principal New York cases relied on by the corporate trustees were *Mittelman* v. *Manhattan Co.,* 248 App. Div. 79, aff'd 272 N. Y. 632; *Weil* v. *Manhattan Co.,* 275 N. Y. 238 and *Elkind* v. *Chase National Bank,* 259 App. Div. 661, aff'd 284 N. Y. 726. The Circuit Court analyzed, interpreted and distinguished said decisions and it is interesting to note that while the *Manufacturers Trust Company* case was decided on February 3rd, 1942, the New York Court of Appeals on April 23rd, 1942, in *In re Lawyers Westchester Mortgage & Title Co., Hurdman* v. *Berckhead,* 288 N. Y. 40, itself construed the *Mittelman* and *Weil* cases precisely as they were interpreted by the Circuit Court. The *Elkind* case, *supra,* as well as the case of *Emmerick* v. *Central Hanover Bank and Trust Co.,* 34 N. Y. S. (2d) 166 (not otherwise reported), were made the basis of the application to this Court for a writ of certiorari in the *Manufacturers Trust Company* case *supra,* and the writ was denied 316 U. S. 697.

The petitioner now reasserts that the decisions of the Circuit Court of Appeals in the instant case and in *Manufacturers Trust Co.* v. *Kelby, supra,* are in conflict with New York Law (specification of Errors 4, 5, 6 and 7) and it claims that a bondholder possesses an alternative right and remedy under the law in New York State; that based on the ownership of a bond it is an equitable owner *pro tanto* of the security underlying all the bonds secured by the trust fund and it had a right to sue the trustee in an action at law, prior to the maturity of its bond, for alleged damages it sus-

tained by reason of an impairment of the security, and that such right was not transferred or lost by the assignment of its bond.

It is concededly true, that under the New York Law, a creditor, secured by a mortgage, has a cause of action against the mortgagor or a third party for an impairment of the mortgage security.

Van Pelt v. *McGraw,* 4 N. Y. 110;
Ferraro v. *Weisman,* 136 Misc. 61, 242 N. Y. S. 73;
President and Directors of the Manhattan Company v. *Mosler Safe Co.,* 246 App. Div. 785, 284 N. Y. S. 145.

However, the interest of a mortgagee in the property mortgaged is but a contingent interest, and if notwithstanding the injury to the security, the mortgagee's debt were paid in full, all his right and interest in the security would cease and terminate; and if prior to maturity of his debt or its payment, he sued and recovered damages, such recovery would *pro tanto* constitute a reduction to possession of the legal title to such contingent interest and would have to be credited on the debt.

Ferraro v. *Marrilard Builders,* 227 App. Div. 448, 238 N. Y. S. 188;
Syracuse Savings Bank v. *Onondaga Silk Co. Inc.,* 171 Misc. 993, 14 N. Y. S. 2d 356.

Such an action by a mortgagee for impairment of the security is not an action on the bond or the mortgage—but arises out of the tortious act of a mortgagor or other party in partially destroying the mortgaged *res.*

Morgan v. *Waters,* 122 App. Div. 340, 106 N. Y. S. 882;
Syracuse Sav. Bank v. *Onondaga Silk Co.,* 175 Misc. 811, 26 N. Y. S. 2d 448.

Petitioner erroneously applies the principle that a mortgagee, holding a legal title, has a cause of action for damages impairing his security to a bondholder who holds no legal title to but only an equitable interest in the security the legal title to which is in a corporate trustee and secures not only petitioner, but approximately 1800 other bondholders. Assuming, *arguendo,* that petitioner when it held its bond, acquired any such right of action for damages individually suffered by it, as a corollary to such right it would be obliged to credit any recovery on its bond. But what it assigned was the bond for $1,000.00 which it held, without any reservation of the alleged cause of action, and without any deduction on the debt by the amount of the claimed damages.

Obviously, as the petitioner's interest in the trust fund was simply a contingent one, as security for its bond, such contingent interest could subsist only as long as petitioner owned the bond or debt—and upon the assignment of the debt and the transfer of the bond, petitioner's contingent interest in the security likewise passed to its assignee.

> *Vail* v. *Foster,* 4 N. Y. 312;
> *Chapman* v. *Brooks,* 31 N. Y. 75;
> *Craig* v. *Parkis,* 40 N. Y. 181;
> *Virginia Ry & Power Co.* v. *Davis,* 284 Fed. 479.

The gravamen of petitioner's claim in the State Court action is that it was a creditor of Prudence Bonds Corporation; that it had an equitable right in a trust *res* securing its debt; that the trustee of the *res* violated its duties; and that this situation gave rise to a claim in petitioner against the trustee in its individual capacity for damages—notwithstanding petitioner sold its bond and ceased to be a creditor of the maker of the bond. The fallacy of petitioner's position is to be found in its erroneous assumption that the claim

against the trustee in its individual capacity for damages accrued to and resides in each beneficiary of a trust estate. This is not so.

Ordinarily a *cestui* or beneficiary of a trust estate has no independent cause of action either in his own right or that of the trust estate to recover money or property wrongfully diverted by the trustee. Such a cause of action resides solely in the trustee, but if the trustee, after due demand failed to act, or if such demand would be futile, then any beneficiary may maintain a representative action in behalf of himself and all beneficiaries. The action by the beneficiary is a derivative one, brought in the right of the trustee and the trust fund.

O'Beirne v. *Allegheny & Kinzna R. R. Co.*, 151 N. Y. 372;
Agne v. *Schwab*, 123 App. Div. 746, 108 N. Y. S. 487;
Western R. R. Co. v. *Nolan*, 48 N. Y. 513;
McQuaid v. *Perot*, 223 N. Y. 75;
Harvey v. *McDonnell*, 113 N. Y. 526;
Bonham v. *Coe*, 249 App. Div. 428, 292 N. Y. S. 423, aff'd 276 N. Y. 540;
Hart v. *Goadby*, 138 App. Div. 160; 123 N. Y. S. 166.

In the case of *Hart* v. *Goadby, supra*, the Court says:

"And where personal property is held by executors or trustees in trust, and they have been guilty of a devastavit in wrongfully diverting trust funds, the action to recover the same is vested in them or their successors, and can only be maintained by them or their successors, excepting in exceptional cases where they refuse on demand to bring the action, or a demand on them would be futile, in which event the action may be brought by

the beneficiaries * * * bringing the action in behalf of all parties interested in the estate."

These principles are equally applicable whether the beneficiary claims a right to the restoration of the *res*, or money damages for an impairment of the *res* as security for his debt. The right to recover the *res*, or to collect damages for the depreciation of the *res* resides primarily in the trustee. To whatever extent a wrongdoer has impaired the security, the right of action for damages can only accrue to the holder of the legal title to the security, *i.e.*, the trustee, and any rights that the beneficiary possessed are purely derivative and can only be asserted by one beneficiary as representative for all. Whether such actions for damages to the security were instituted by the trustee, or a derivative action were brought by a bondholder, the recovery, if any, would become part of the trust fund; it would not go to the individual bondholder. The right of the bondholder in a trust fund is peculiarly analogous to the right of a stockholder in the assets of a corporation. In a stockholders' derivative action against directors, any recovery inures to the corporation and the rationale of the decision of the New York Court of Appeals in *Pollitz* v. *Gould*, 202 N. Y. 11, is especially apposite.

In that case because the rights of the stockholders in the assets of a corporation are indivisible, it was there held that an action to recover assets of the corporation was properly brought as a representative or class action on behalf of all stockholders and that the right of action passed with a transfer of a shareholder's stock. So too, in the case at bar, since the rights of the bondholders in the trust *res* or fund are indivisible, any suit, action or claim for the recovery of assets comprising a part of the trust *res* or fund inures to the benefit of all the bondholders, regardless of whether they

were such at the times the acts questioned were committed, and regardless of when a bondholder acquired his bond.*

Petitioner in its brief directs the attention of this Court to no carefully considered case in New York State which questions the above cases as controlling, authoritative and correct expositions of the law of New York State as to the right of an individual bondholder to maintain an action for damages against a corporate trustee, based on a claim that the trustee violated the express terms of the trust indenture. In the footnote on page 17 of its brief it cites several cases purporting to hold that such right in a bondholder to sue for his individual damages is "well settled". An examination of the cases it cites does not warrant the statement made, and they certainly do not cast such doubt on what the New York Law is as to justify the suggestion that the District Court, in its discretion, should have declined to determine what the indisputable law of New York State is.

The case of *Ansbacher* v. *New York Trust Co.*, 280 N. Y. 79 was not an action by an individual bondholder. Plaintiff was suing in a representative capacity "individually and on behalf of all bondholders" and the sole question certified to the Court of Appeals in that case was whether certain defenses predicated on exculpatory provisions of the trust indenture were "sufficient in law on their face". The Court of Appeals answered the question in the affirmative. There was no discussion or decision on the question as to whether

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* The trust indenture provides that it was made in consideration of "the purchase and acceptance from time to time of said Prudence Bonds by the holders thereof" (Manufacturers R. 25) that the trust fund is for the equal and pro rata benefit and advantage of all bonds (M. R. 26), irrespective of the actual date of the issuance and negotiation of the bonds (M. R. 25, 26, 37, 43) and contained a restraint clause prohibiting the enforcement of any right under the agreement except for the pro rata benefit of all bondholders (M. R. 57). Cf. *Batchelder* v. *Council Grove Water Company*, 131 N. Y. 42; *Commonwealth & Susquehanna & D. R. R. Co.*, 122 Pa. St. 306.

a bondholder could maintain an individual action for damages, or as to who were proper parties plaintiff.

The case of *Benton* v. *Safe Deposit Bank of Pottsville,* 255 N. Y. 260 was not predicated on any alleged breach of any covenant or term of the trust agreement. It was an action in negligence, and the capacity of the plaintiff to maintain an action for individual damages was not considered or passed on. The sole question presented was "the liability to bondholders of a trustee * * * for failure to record the mortgage" where by the trust indenture—made in Pennsylvania—the trustee was absolved from the duty to record same. The Court applied the Law of Pennsylvania to an interpretation of the agreement, found that under the Pennsylvania Law the agreement was legal and enforceable and decided that "in the absence of gross or wilful negligence there was nothing immoral about the trustee's agreement so as to render the application of the Pennsylvania Law repugnant to the public policy of New York State.

Savings Bank of New London v. *New York Trust Company,* 27 N. Y. S. (2d) 963 was an action by plaintiff on behalf of all holders of outstanding bonds—totalling $345,000 of which plaintiff owned $200,000 and the case has no application on the issues involved herein.

Bank of New York v. *New Jersey Title Guarantee and Trust Co.,* 256 App. Div. 609; 11 N. Y. S. (2d) 181 was not an action by an individual bondholder for his individual damages. The action was by a successor trustee for damages against the predecessor trustee for breach of covenant in the trust agreement in surrendering securities to the wrong party, there being no claim that the former trustee derived any profit from the transaction. The Court held that an action for damages was maintainable by the "present owner of the assets of the Trust". The "present owner" was the successor trustee—who was the plaintiff, and the case is in full accord with the principle hereinabove claimed by respondent to be the law of New York State.

Margulies v. *Manufacturers Trust Co.*, 148 Misc. 564, 266 N. Y. S. 657 was a decision of the Appellate Term on an appeal from the City Court of the City of New York. The question involved in this case was not analyzed and considered by the Court. The facts do not appear in the opinion which was but a short memorandum and cited *Hunsberger* v. *Guarantee Trust Co.*, 164 App. Div. 740, 150 N. Y. S. 190, affirmed 218 N. Y. 742, and *Doyle* v. *Chatham Phenix Nat. Bank*, 253 N. Y. 369. The *Doyle* case did not involve any right of a *cestui que* trust against a trustee for breach of duty; that was a case where a buyer sued because of a false certification relied on by him in making his purchase of a bond, and the action was grounded on deceit. In the *Hunsberger* case *supra*, the right of an individual bondholder to maintain an independent action for damages apparently was not raised, considered or passed on by the Court.

Petitioner also stresses the case of *Emmerich* v. *Central Hanover Bank & Trust Co.*, 34 N. Y. S. 2d, 166, in which on motion to dismiss the complaint in an action by an individual bondholder for damage, the Special Term granted the motion. In granting the motion the Special Term purported to act on the authority of *Elkind* v. *Chase National Bank*, 259 App. Div. 661, aff'd no opinion 284 N. Y. 726 and *Hendry* v. *Title Guarantee & Trust Co.*, 255 App. Div. 497, aff'd in part, no opinion 280 N. Y. 740.

The granting of the motion by the Special Term is in complete accord with the New York Law. As pointed out above, the plaintiff had no individual cause of action, and whether the plaintiff owned his bond at the time of the alleged breaches of trust, or acquired his bond thereafter, is entirely immaterial. The citation by the Court of the *Hendry* and *Elkind* cases *supra* shows a complete misapprehension of the issue involved and the law applicable thereto. The Court will recall that on the petition to this Court

for a writ of certiorari in the case *Manufacturers Trust Co.* v. *Kelby,* 125 F. 2d 650, cert. denied 316 U. S. 697 the petitioner stressed the *Hendry* and *Elkind* cases as the basis of the contention that the Circuit Court failed to follow and apply the New York Law. The petitioner herein recognizes that the Circuit Court correctly distinguished said cases and that they are inapposite and very properly does not in its brief make any reference thereto. The affirmance without opinion by the Appellate Division does not constitute an adoption or acceptance of the reasoning of the lower Court.

None of the cases cited by petitioner cast any doubt on the decision of the Court of Appeals in *O'Beirne & Allegheny & Kinzua R. R. Co.,* 151 N. Y. 372, *Western R. R.* v. *Nolan,* 48 N. Y. 513 or the decision by the Appellate Division in *Agne* v. *Schwab,* 123 App. Div. 746 and *Hart* v. *Goadby,* 138 App. Div. 160, and in so far as the petition is predicated on the failure of the Circuit Court to apply New York Law—it is entirely without merit and should be denied.

II.

Section 265 of the Judicial Code (28 U. S. C. 379) is no bar to the granting of the injunction in this case.

While Section 265 of the Judicial Code appears by its terms to prohibit a Federal Court from issuing any injunction "to stay proceedings in any court of a state, except in cases where such injunction may be authorized by any law relating to proceedings in bankruptcy" this Court has held that the section is not a limitation on the jurisdiction of the Federal Court, but merely goes to the question of equity in the particular issue presented for determination.

The Federal Court, having jurisdiction of the subject matter and of the parties by virtue of some Federal statute, thereupon becomes vested with the power to issue an injunction restraining any proceeding in the State Court, if under the particular facts in each case the issuance of such injunction is equitable and just. The contention of petitioner that the only exception engrafted by judicial construction on the sweeping prohibition contained in Section 265 is a case involving the possession and protection of a *res* is unsound.

In the case of *Toucey* v. *N. Y. Life Ins. Co.,* 314 U. S. 118, principally relied on by petitioner, this Court recognized that the prohibition of Sec. 265 has always been deemed inapplicable to removal proceedings, and that the true rationale of the "removal cases" is that the Removal Acts qualify such prohibition *pro tanto.* Likewise the prohibition is inapplicable to suits involving Limitations of Ship Owners Liability, proceedings under the Interpleader Act of 1926, or the Frazier Lemke Act because of the jurisdiction conferred upon the Federal Courts under the statutes. The issue presented and decided in the *Toucey* case was reduced to a very narrow question "Does a Federal Court have power to stay a proceeding in a State Court *simply* because the claim in controversy has previously been adjudicated in the Federal Court? Neither the *Toucey* case, nor *Southern Ry.* v. *Painter,* 314 U. S. 155 expressly or by implication repudiated or overruled the principle of law previously enunciated by this Court that, granted the premise that the Federal Court had jurisdiction of the parties and subject matter of an equity proceeding by virtue of some Federal Statute, the equity powers of the Federal Court are as broad as those of the State Court, and if on equitable principles the State Court would have power to and would issue an injunction staying a proceeding in another State Court, if the same litigation were

pending in the Federal Court, in like circumstance the Federal Court could and would enjoin proceedings in the State Court.

In *Sovereign Camp of Woodman* v. *O'Neill,* 266 U. S. 292, a conspiracy was entered into by approximately 25 separate claimants to institute actions against the petitioner on claims ranging from $987 to $1170 each. The petitioner filed a bill in the Federal Court for an injunction to restrain such contemplated actions in the State Court, and the Federal Court having decided that it had jurisdiction based on diversity of citizenship and because the aggregate claims exceeded $3,000.00, granted the injunction. This Court, referring to Section 265 of the Judicial Code said:

> "This section does not deprive a district court of the jurisdiction otherwise conferred by the Federal Statute, but merely goes to the question of the equity of the particular bill; making it the duty of the Court, in the exercise of its jurisdiction, to determine whether the specific case presented is one in which relief by injunction is prohibited by this section or may nevertheless be granted".

In *Looney* v. *Eastern Texas R. Co.,* 247 U. S. 214, this Court said:

> "The use of the writ of injunction, by federal Courts first acquiring jurisdiction over the parties or the subject matter of a suit, for the purpose of protecting and preserving that jurisdiction until the object of the suit is accomplished and complete justice done between the parties is familiar and long established practice. * * * So important is it that unseemly conflict of authority between State and Federal Courts should

be avoided by maintaining the jurisdiction of each free from the encroachments of the other, that Sec. 265 of the Judicial Code, Rev. Stats. Sec. 720 Act of March 2, 1793 C. 22, 1 Stat. 334 has repeatedly been held not applicable to such an injunction. Julian v. Central Trust Co., 193 U. S. 93; Simon v. Southern Ry. Co., 236 U. S. 115".

That case was followed in *Supreme Tribe of Ben Hur* v. *Cauble,* 255 U. S. 356, where the Court said:

"The District Courts of the United States are courts of equity jurisdiction, with equity powers as broad as those of state courts. That a class suit of this nature might have been maintained in a State Court, and would have been binding on all of the class we can have no doubt. Hartford Life Ins. Co. v. Ibs, 237 U. S. 662, 672; Royal Arcanum v. Green, 237 U. S. 531".

The majority opinion in *Toucey* v. *New York Life Ins. Co., supra,* did not reject *Looney* v. *Eastern Texas R. Co.,* 247 U. S. 214 as sound law and an authoritative precedent, but distinguished it as "not a relitigation case;" nor did it overrule *Supreme Tribe of Ben-Hur* v. *Cauble,* 255 U. S. 356, where it was held that the federal court, having rendered a decree in a class suit brought in behalf of all members of a certain class of beneficiaries in a fraternal association, may enjoin members of the class, found to be bound by the decree, from prosecuting suits in the State Court which would relitigate questions settled by such decree. This Court warned against erroneous implications being drawn from said case as making relitigation cases an exception to the prohibition contained in Sec. 265, U. S. Code.

These cases must be construed in the light of the doctrine laid down by this Court in *Erie* v. *Tompkins,* 304 U. S. 64 that

> "Except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State. And whether the law of the State shall be declared by its Legislature in a Statute or by its highest Court in a decision is not a matter of federal concern. There is no federal common law".

Thus construed, it follows from these decisions, that where a federal court has issued an injunction simply because the case before it involved a relitigation of the issue previously determined by it, such injunction violates the prohibition contained in Section 265; but if the injunction were issued not "simply" because the case involved a "relitigation" but in addition thereto there was other ground for its use—in accordance with equitable principles as they would be applied under the law of the State, then Section 265 is inapplicable. That is but another way of saying, that in the re-litigation cases, under the law of the State, there was an adequate remedy at law, in a plea of *res adjudicata* rendering it unnecessary for the intervention of the equitable arm of the Court.

So, in the case at bar, the inquiry into the merits of the petition for a writ of certiorari necessitates a determination of the question, whether, if the accounting proceeding pending below were in fact being litigated in the Supreme Court of the State of New York, would the State Court under the circumstances of this case enjoin the petitioner from prosecuting an independent action against the accounting trustee and the beneficiaries of the trust?

It is respectfully submitted that under the New York Law the answer to this question must be in the affirmative. However, emphatically petitioner asserts it does not make any claim against any *res* in the possession and control of the Court, a realistic view of the fact is that

its action is founded on an alleged improper depletion of the trust *res* which constituted the collateral security for its bond. It is endeavoring to enforce a right arising out of a contingent interest in such trust *res*. The proper administration by the Trustee of such trust *res* is the subject matter of the proceeding instituted by the trustee for the judicial settlement of its account and the issues raised by the objections to such account. The accounting proceeding under New York Law is a plenary one, the petition, account and objections constituting the pleadings, *Matter of Hearns,* 214 N. Y. 426, at 432; *in re: Juillard's Will,* 169 Misc. 270; 7 N. Y. S. 2d, 290, in which petitioner claiming the infringement of any equitable rights in the trust *res* could intervene, assert, and litigate its claim. The Court having acquired plenary jurisdiction of the parties and of the subject matter could and would in the accounting action, enjoin the prosecution of a separate proceeding by an individual claimant in the exercise of its equitable power to prevent a multiplicity of suits and upon the familiar equitable principle that where full relief can be had in one suit equity will allow no other suit to be maintained.

Scheule v. *Reiman,* 86 N. Y. 270;
Gould v. *Gould,* 118 Misc. 576, 195 N. Y. S. 113;
Gould v. *Gould,* 203 App. Div. 817, 197 N. Y. S. 524;
Whitney v. *Delaney,* 73 N. Y. 571;
Cf. Colson v. *Pelgram,* 259 N. Y. 370;
Husted v. *Thomson,* 158 N. Y. 328 at 337.

In *Metropolitan Trust Co.* v. *Stallo,* 166 App. Div. 639, 152 N. Y. S. 183, the Court said:

"The authority of the Supreme Court sitting as a Court of Equity, and indeed its duty, in a proper case,

to stay proceeding in another court, is so well established that it will not be questioned. The only inquiry is as to when a proper case is presented * * * nor is it an insuperable objection to such an injunction that it restrains the prosecution of proceedings as to which the Surrogate's Court has concurrent or exclusive jurisdiction. * * * While the jurisdiction and authority of the Supreme Court to restrain the prosecution of proceedings in other tribunals are not necessarily determined by the priority of institution, the case for such restraint is much strengthened when, as in this case, the commencement of the action in the Supreme Court antedates the commencement of the action or proceeding sought to be enjoined. In Scheule v. Reiman, 86 N. Y. 270, the Court of Appeals said:

> "'Where the object of two legal proceedings is the same; convenience, as well as a proper regard for the rights of a debtor and creditor, require, if possible, that the fund in which both are interested should be subjected to diminution by one litigation only, and the parties themselves spared the unnecessary labor and expense of conducting two controversies over the same matter. It would seem, also, that if both tribunals, whose interference has been invoked have equal or concurrent jurisdiction, it should continue to be exercised by that one whose process was first issued.'"

This Court in *Princess Lida* v. *Thompson,* 305 U. S. 456, sustained an injunction issued by the State Court against an accounting action brought in the Federal Court pending a similar prior accounting in the Pennsylvania State Court. It is inconceivable that if the situation were reversed and the proceeding had been first instituted in the Federal

Court that the parties would not have been entitled to enjoin a subsequent proceeding in the State Court. To so hold would reject the doctrine of *Erie* v. *Tompkins, supra,* that the law to be applied in the case is the law of the State, and would deny to a litigant the substantive rights to protection by injunction accorded to him by the law of the State.

The decision of this Court in *Toucey* v. *N. Y. Life Insurance Co.,* 314 U. S. 139 was not intended to produce any such result.

CONCLUSION.

The petition should be denied.

Respectfully submitted,

SAMUEL SILBIGER,
Counsel for Respondent, George E. Eddy.

Dated, May 25, 1943.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

No. 1008

IN THE MATTER

OF

PRUDENCE-BONDS CORPORATION,

Debtor.

In the Matter of the Application of CHARLES H. KELBY and CLIFFORD S. KELSEY, as Trustees of the Debtor, and PRUDENCE-BONDS CORPORATION (New Corporation), for an order herein restraining and enjoining all parties to a certain action in the Supreme Court of the State of New York, New York County, entitled "Brooklyn Trust Company, as Trustee under the will of Susanna E. Coffin, deceased, Plaintiff, against President and Directors of the Manhattan Company; George E. Eddy; Hilda S. Reese; and Prudence-Bonds Corporation (New Corporation)," from taking any further steps and proceedings therein.

BROOKLYN TRUST COMPANY, as Trustee of a trust created in and by the will of Susanna E. Coffin, deceased,

Petitioner,

against

CHARLES H. KELBY and CLIFFORD S. KELSEY, as Trustees of the Debtor; PRUDENCE-BONDS CORPORATION (New Corporation); GEORGE E. EDDY; HILDA S. REESE, and PRESIDENT AND DIRECTORS OF THE MANHATTAN COMPANY,

Respondents.

BRIEF FOR RESPONDENTS TRUSTEES OF DEBTOR, PRUDENCE-BONDS CORPORATION (NEW CORPORATION), AND HILDA S. REESE, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Opinions Below

The opinion of the Circuit Court of Appeals (R. 305) is reported in 134 F. (2d) 105.[1]

The opinion of the District Court (R. 279) is not reported.

Jurisdiction

The opinion of the Circuit Court of Appeals was rendered February 16, 1943, and the decree and order for the mandate thereon was entered March 9, 1943.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (U. S. Code, Title 28, Sec. 347).

Statement

The order affirmed by the Circuit Court of Appeals was made by the bankruptcy court in the proceeding for reorganization of Prudence-Bonds Corporation, Debtor, under Section 77B of the Bankruptcy Act. Such order temporarily restrains the parties to a certain action in the Supreme Court of the State of New York, from taking any further proceedings therein, pending proceedings in the reorganization court by Corporate Trustees of the Debtor's bond issues for the judicial settlement of accounts of their acts as such Trustees.

The "Questions Presented" in the petition are based upon certain erroneous assumptions of material facts and petitioner's "Statement of Facts" is both inaccurate and incomplete.

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[1]In its opinion, the Circuit Court of Appeals noted the fact that, "The record on this appeal consists of some 1300 printed pages, for it incorporates by reference the record on appeal in *Central Hanover Bank* v. *Manhattan*, 105 F. (2d) 130, and that in *Manufacturers Trust Co.* v. *Kelby*, 125 F. (2d) 650" (R. 306).

The "Questions Presented" erroneously assume that the Debtor's Plans of Reorganization have been consummated, and that the old Corporate Trustees of the Debtor's bond issues have turned over all of the property securing the bonds to a new Corporate Trustee, appointed with the approval of the bankruptcy court. The "Statement of Facts" erroneously states that the bankruptcy court surrendered its control over the property of the Debtor, and presents a distorted picture of the state court action.

The opinion of the Circuit Court of Appeals (R. 305), to which we respectfully refer the Court, contains a full statement of the case. In view of this fact and in order not to unduly burden the Court, we will not here set forth the statement which would otherwise be required to correct the inaccuracies and make complete the "Statement of Facts" contained in the petition. It will be seen from the opinion that the Debtor's Plans of Reorganization, although confirmed, have not been consummated or carried out; that the bankrupt estate is still in the process of administration in that the old Corporate Trustees of the Debtor's bond issues, including Brooklyn Trust Company and Bank of Manhattan, are accounting in the bankruptcy proceeding for their acts with respect to the Trust Funds securing the Debtor's bonds (R. 307-310); that the bankruptcy court took exclusive jurisdiction over such accountings for the express purpose of making effective, consummating and carrying out the confirmed Plans of Reorganization (R. 311); that the reorganization proceeding is still pending; and that the bankruptcy court has not surrendered control over the property of the Debtor (R. 311, 314-316).

The picture of the state court action which petitioner presented to the Circuit Court of Appeals was so distorted as to cause that Court to conclude, that "this picture of the nature of the actual state court suit begun by Brooklyn is importantly inaccurate" (R. 321). The picture of the state court action which petitioner presents to this Court is likewise "importantly inaccurate". The real nature of that

action is clearly revealed in the opinion of the Circuit Court of Appeals (R. 316-322, 326-329), and shows, as the Courts below found, that the state court action clearly constitutes an unlawful interference with the jurisdiction of the bankruptcy court and the *res* in its custody (R. 284-285, 322).

I

There is no conflict between the decision of the Circuit Court of Appeals and the decisions relied upon by the petitioner.

Petitioner contends that the decision of the Circuit Court of Appeals is in conflict with many highly important decisions of this Court and several decisions of the Circuit Courts of Appeals. This contention is wholly unwarranted. It is akin to petitioner's reckless assertion that the statements in the opinion of the Circuit Court of Appeals "arbitrarily assume the applicable substantive law to be the opposite of what it actually is" (Petitioner's Brief, p. 26). The fact is, as we shall show, that this Court has already considered and declined to review most of the alleged errors specified by the petitioner.

Petitioner's claimed conflict of decisions is based upon two assumptions: (1) that there is no *res* involved in the proceedings in the bankruptcy court for the judicial settlement of the accounts of the Corporate Trustees of the Debtor's bond issues; and (2) that in deciding issues involved in the accounting proceedings, the Circuit Court of Appeals has ignored and failed to follow the law of New York.

Assuming the absence of a *res,* petitioner contends that the "hands off" doctrine of *Toucey* v. *N. Y. Life Ins. Co.,* 314 U. S. 118, and similar cases, applies. If its contention on this score be rejected, it insists that, since a question of New York law is involved, this Court should encourage and permit the state court action upon principles set forth in *Foust* v. *Munson Lines,* 299 U. S. 77; *Railroad Comm'n* v. *Pullman Co.,* 312 U. S. 496; and *Chicago* v. *Fieldcrest Dairies,* 316 U. S. 168.

The assumption that there is no *res* involved in the bankruptcy proceeding has been determined to be erroneous in two earlier decisions of the Circuit Court of Appeals in this same reorganization proceeding. These decisions are: *Central Hanover Bank & Trust Company, et al.* v. *President and Directors of the Manhattan Company, et al.*, 105 F. 2d 130, and *Manufacturers Trust Company* v. *Kelby*, 125 F. 2d 650, cert. denied, 316 U. S. 697.[2] These decisions

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[2] In the decision now sought to be reviewed the Circuit Court of Appeals said (R. 331):

> "* * * while, ordinarily, such a fact (the denial of certiorari) is not to be accorded too much weight, it may be said to have unusual force here, for the petition for certiorari urged the Supreme Court to grant the writ on the ground that the matter of jurisdiction should be promptly passed upon by the Supreme Court so that, if jurisdiction were lacking, there would be avoided lengthy, complicated and expensive accountings, and on the further ground that numerous practical future problems would be settled, including 'the effect of efforts to stay proceedings in the state courts.'
>
> In that petition it was said that, if the decisions of this court were not reversed, there would be 'no protection' to the old corporate trustees 'against claims which may be made by those who held bonds at the time of the alleged breaches of trust, who are not before the court and who will not be bound by the judgment.'"

The day after the denial of certiorari in the *Manufacturers Trust Company* case, Brooklyn Trust Company voluntarily withdrew and discontinued its appeal from an order of the bankruptcy court of the same nature as the order involved in the *Manufacturers Trust Company* case (R. 28, 30-31, 316). A few days later, ostensibly acting as Trustee of the Coffin Estate, which once held a Fifth Series Prudence bond, Brooklyn Trust Company instituted the state court action (R. 33), alleging in the complaint that the decisions of the Circuit Court of Appeals "do not conform to or follow the law of the State of New York" (R. 55). Such action as the Court below said, was instituted "obviously by prearrangement with" Bank of Manhattan, the principal defendant (R. 317, see also footnote "29", R. 328). In the District Court, counsel for Brooklyn Trust Company affirmatively stated that in the state court action the two Banks were "fighting each other so that anything that would be opposed to the Circuit Court of Appeals construction would be satisfactory to both parties" (R. 269).

also show that the Circuit Court of Appeals followed the New York law. In the *Manufacturers Trust Company* case the Court made a careful analysis of the New York cases relied upon by the Corporate Trustees (R. 312), and its opinion shows that its determination was in accordance with New York law. Moreover, many additional New York cases showing that its decision followed well settled New York law, were cited in the respondents' brief filed in this Court in opposition to the petition for certiorari in such case. The specifications of error in the petition for certiorari, which was denied, were that the bankruptcy court had no jurisdiction of the subject matter of the accounting proceedings and that the Circuit Court of Appeals had failed to follow the law of New York (R. 29-30).

Petitioner now again seeks to review the two earlier decisions of the Circuit Court of Appeals.[3] This is clear from its contention as to the absence of a *res*, its contention that the Circuit Court of Appeals ignored and failed to follow the law of New York, and its specifications of error Nos. 4 to 8 inclusive, which are based upon such contentions (Petition, pp. 12-13).

The decision of the Circuit Court of Appeals now sought to be reviewed and the two earlier decisions of that Court amply demonstrate that there is a *res* involved in the accounting proceedings in the bankruptcy court. They also show that there is no warrant for petitioner's contention that the Circuit Court of Appeals has ignored and arbi-

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[3] Brooklyn Trust Company, along with all of the other Corporate Trustees, were parties to the *Central Hanover* case (R. 310-311). In the *Manufacturers Trust Company* case, Brooklyn Trust Company, Bank of Manhattan, and four of the other Corporate Trustees, filed a brief *amicus curiae* in support of the appeal of Manufacturers Trust Company (R. 312). Moreover, Brooklyn Trust Company and Bank of Manhattan each paid a proportionate part of the fee of special counsel (R. 29) who filed the certiorari petition for Manufacturers Trust Company (R. 313). Such petition, as the Circuit Court of Appeals pointed out, "asked reversal not only of our decision in the *Manufacturers Trust* case but also of our previous decision, as to jurisdiction, in the *Central Hanover* case (R. 313-314).

trarily failed to follow the law of New York. They destroy the foundation upon which petitioner has created its claimed conflict of decisions.

All of the arguments advanced in the petition are fully answered in the opinion of the Circuit Court of Appeals. There is no conflict of decisions. Most of the decisions relied upon by petitioner are discussed and distinguished in the opinion of the Circuit Court of Appeals. And it will be seen from the opinion, that the other cases relied upon by the petitioner are not applicable to the case at bar. The restraining order of the bankruptcy court comes within two of the recognized exceptions to the doctrine of the *Toucey* case *supra,* namely, bankruptcy proceedings and the *res* cases. The bankruptcy court in granting the restraining order was well within its powers as a court of equity or under the broad provisions of Section 2a(15) (11 U. S. C. A., Sec. 11a(15)) of the Bankruptcy Act, or of Section 262 (28 U. S. C. A., Sec. 377) of the Judicial Code (*Farmers Loan & Trust Co.* v. *Lake St. Elevated R. Co.,* 177 U. S. 51; *Kline* v. *Burke Construction Co.,* 260 U. S. 226; *Ex parte Baldwin,* 291 U. S. 610; *Local Loan Co.* v. *Hunt,* 292 U. S. 234; *Continental Bank* v. *Rock Island Ry.,* 294 U. S. 648; *United States* v. *Bank of New York Co.,* 296 U. S. 463; *Steelman* v. *All-Continent Co.,* 301 U. S. 278; *Princess Lida* v. *Thompson,* 305 U. S. 456; *In re Skorez,* 67 F. 2d 187; *Dealty* v. *Posse School,* 100 F. 2d 470; *In re Hermitage Bldg. Corp.,* 100 F. 2d 597; *Collier on Bankruptcy,* 14th Ed., Vol. 1, pp. 253-254; *Cf. Looney* v. *Eastern Texas R. Co.,* 247 U. S. 214).

The *Steelman* case *supra,* is closely analogous, and the decision of this Court in such case fully supports the jurisdiction of the bankruptcy court to make the restraining order in the instant case. Indeed, as the Circuit Court of Appeals pointed out, "Here the facts are stronger than in the *Steelman* case" (R. 329). The state court action was instituted by Brooklyn Trust Company by prearrangement with Bank of Manhattan, the principal defendant, for the avowed purpose of defeating the liability sought to be

imposed upon the two Banks in the bankruptcy proceeding (R. 40, 273, 281, 283, 327). The issues in the action are deliberately narrowed and the pleadings are so contrived as to "shut out the light" (301 U. S. 278, 285). As the Circuit Court of Appeals stated (R. 330):

> "In the suit brought by Brooklyn, the issues are misleadingly narrowed and artificially presented; the true issues we conclude, cannot be adequately determined in such a suit begun in the circumstances and for the purposes above narrated."

Such determination not only brings the instant case squarely within the rule of the *Steelman* case; it also leaves no room for the application of the principles enunciated in *Gilchrist* v. *Interborough Rapid Transit Co.*, 279 U. S. 159; *Chicago* v. *Fieldcrest Dairies; Railroad Comm'n* v. *Pullman;* and *Foust* v. *Munson Lines, supra.*

In the first place, as the Circuit Court of Appeals said with regard to such cases (R. 325):

> "* * * But none of the cases in which the Supreme Court has said that federal courts should, for that purpose, encourage (or allow to go unmolested) state court litigation has involved a federal suit in which the federal court first obtained jurisdiction of a *res* and where a subsequent state court suit would involve an interference with the jurisdiction of the federal court."

Secondly, as the Circuit Court of Appeals also said (R. 326):

> "* * * in the suit brought by Brooklyn, the issues involved in the bankruptcy restoration action are presented to the state court in a manner and in circumstances which make it unlikely that state court rulings could be helpfully obtained" (R. 326).

Lastly, the necessity for any state court suit to obtain a decision on a novel and unsettled question of state law does not exist. The state law, as we have shown, is well settled,

and the bankruptcy court and the Circuit Court of Appeals have decided the pertinent questions in accordance with the state law.[4] Manifestly, the mere fact that state law may be involved in a case in the federal court, and more particularly the bankruptcy side of the court, does not require the federal court to stay its hand and send the matter to the state court for adjudication (*Alexander* v. *Hillman*, 296 U. S. 222). *A fortiori*, the bankruptcy court should not stay its hand to permit or encourage a state court suit like the one here involved, where the issues are "misleadingly narrowed and artificially presented", and where there is no real controversy between the dominant plaintiff and defendant who appear as adverse parties to the suit, who will control the litigation, and whose sole object is to defeat the liability sought to be imposed on them

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[4] The decision of the New York Special Term in *Emmerich* v. *Central Hanover Bank & Trust Co.*, 34 N. Y. S. (2d) 166 (not officially reported), affd. no opinion, 265 App. Div. 808, affords no basis for granting certiorari. The opinion in the case was printed in full in an appendix to the brief in support of the petition for certiorari in the *Manufacturers Trust Company* case. The later affirmance without opinion merely "adopts the result of the Special Term, but not the reasoning of the justice by which he arrived at the result" (*Viertels* v. *New York, Ontario & Western R. Co.*, 182 App. Div. [N. Y.] 92, 94). The *Emmerich* case was also considered by the Circuit Court of Appeals in the instant case. It was an action at law for damages and is not a case in point. It was clearly distinguished from the *Manufacturers Trust Company* case by counsel for the defendant Central Hanover Bank in his brief in the Appellate Division. Such counsel there said:

> "* * * There is not the slightest attempt on the part of counsel (for plaintiff) to show any similarity between the situation involved in the *Manufacturers Trust Co.* case and that presented in the case at bar. * * * We submit that the *Manufacturers Trust Co.* case upon analysis, is readily distinguishable from the case at bar and plainly not to be accorded the effect attributed to it by counsel for plaintiff."

in the bankruptcy proceeding.[5] Suits of that character are fictitious; they constitute abuses which this and other Courts have reprehended and judicially denominated as frauds (*Lord* v. *Veazie*, 8 How. [U. S.] 250; *Van Horn* v. *Kittitas County*, 112 Fed. 1; *Bell & Howell Co.* v. *Bliss*, 262 Fed. 131; *Judson* v. *Flushing Jockey Club*, 14 Misc. [N. Y.] 350; *Matter of V.*....., 10 App. Div.

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[5] The present insistence that the liabilities of the Corporate Trustees should be adjudicated in the state courts contrasts strangely with the views urged by the Corporate Trustees before it appeared that objections would be filed to their accounts in the bankruptcy court. Formerly they opposed the right of bondholders to maintain suits against them for accountings in the state court and such suits were stayed (*In re Prudence-Bonds Corporation*, 75 F. 2d 262). It is especially significant that at such time (1935), Brooklyn Trust Company, Bank of Manhattan and most of the other Corporate Trustees argued in the Circuit Court of Appeals in justification of such stays (See pp. 430-431 of record on appeal in *Manufacturers Trust Company* v. *Kelby, supra*):

> "If a plan of reorganization for the Debtor herein is approved, or if the Debtor is liquidated in this proceeding, presumably the Trust Companies will be required to account in the bankruptcy court for their acts as trustees under the respective trust indentures. Obviously, to permit promiscuous accounting suits to be brought and prosecuted by individual bondholders in the State courts would only result in duplication of expenses, to the detriment of the majority of the bondholders * * *."

Again, counsel for Manufacturers Trust Company advised its client at that time, "the proper forum for an accounting was in the reorganization proceedings" (R. 431 of said former record). Another Corporate Trustee then contended that the accounting asked in the state court is similar to the accounting that "the Corporate Trustee, will make at the proper time to this Court" (R. 429 of said former record).

The federal courts having held against them on their later accountings to the bankruptcy court, the shift in position emphasizes what Brooklyn Trust Company admitted and what the Courts below found, to wit, that the real purpose of the present fictitious state court suit is to defeat the liability sought to be imposed on it in the bankruptcy proceeding (R. 327; see also, footnote "3", R. 308).

[N. Y.] 491). Only a few days ago, in *United States et al.* v. *Johnson*, decided May 24, 1943, U. S. , this Court reiterated the principles of *Lord* v. *Veazie*, and held that a suit which is not in any real sense adversary lacks a safeguard essential to the integrity of the judicial process and is collusive. As this Court said in the *Steelman* case *supra* (301 U. S. 289-290):

> "* * * If suits can be enjoined when they have a tendency to embarrass administration, *a fortiori* this may be done when there is a basis for the fear that they will be used as instruments or devices to render fraud triumphant."

I I

The restraining order in no way violates any of petitioner's constitutional rights.

The fictitious and collusive nature of the state court suit is clearly indicated by the opinion of the Circuit Court of Appeals. Petitioner has admitted and the Court below found that petitioner Brooklyn Trust Company, as trustee of the estate of Susanna E. Coffin, does not seek to recover any money or property in the state court action and that the real purpose of the action is to defeat the liability sought to be imposed on Brooklyn Trust Company in the bankruptcy proceeding (R. 327, 40, 273). In the light of such admission and finding, the conclusion is inescapable that the Coffin estate does not want or seek its day in the state court, that such estate has not been injured by the restraining order, and that none of its constitutional rights have been violated. It is a fundamental principle that one seeking to raise a constitutional question must show that he is injured by the allegedly unconstitutional statute or order (*Premier-Pabst Sales Co.* v. *Grosscup*, 298 U. S. 226; *Heald* v. *District of Columbia*, 259 U. S. 114; *In re George F. Nord Bldg. Corp.*, 129 F. 2d 173). The constitutionality of the bankruptcy court's

power to issue restraining orders to protect its jurisdiction, the *res* in its custody, and to make effectual its decrees is well established. Moreover, the restraining order here involved is not permanent, the parties to the state court action being only temporarily restrained pending the accounting proceedings in the bankruptcy court.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted,

CHARLES H. KELBY,
Counsel for Charles H. Kelby and Clifford S. Kelsey, Trustees of Debtor,

CHARLES M. MCCARTY,
Counsel for Prudence-Bonds Corporation (New Corporation),

JOSEPH NEMEROV,
Counsel for Hilda S. Reese,

Respondents.

May 26, 1943.

APPENDIX

The Bankruptcy Act, Sec. 2 a (15) (as amended May 27, 1926, c. 406, Sec. 2, 44 Stat. 662; June 22, 1938, c. 575, Sec. 1, 52 Stat. 842, 11 U. S. C. A., Sec. 11 a (15)).

"Sec. 2. *Creation of courts of bankruptcy.* a. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this title, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

* * * * * *

(15) Make such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this title: *Provided, however,* That an injunction to restrain a court may be issued by the judge only;"

The Judicial Code, Sec. 262 (R. S. Sec. 716; Mar. 3, 1911, c. 231, Sec. 262, 36 Stat. 1162, 28 U. S. C. A., Sec. 377):

"Sec. 262. *Power to issue writs.* The Supreme Court and the district courts shall have power to issue writs of *scire facias.* The Supreme Court, the circuit courts of appeals, and the district courts shall have power to issue all writs not specifically provided for by statute, which may be necessary for the exercise of their respective jurisdictions, and agreeable to the usages and principles of law."

JUN 1 1943
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM 1942

No. 1008

IN THE MATTER

of

PRUDENCE-BONDS CORPORATION,

Debtor.

IN THE MATTER of the Application of CHARLES H. KELBY and CLIFFORD S. KELSEY, as Trustees of the Debtor, and PRUDENCE-BONDS CORPORATION (New Corporation), for an order herein restraining and enjoining all parties to a certain action in the Supreme Court of the State of New York, New York County, entitled "Brooklyn Trust Company, as Trustee under the will of Susanna E. Coffin, deceased, Plaintiff, against President and Directors of the Manhattan Company; George E. Eddy; Hilda S. Reese; and Prudence-Bonds Corporation (New Corporation)," from taking any further steps and proceedings therein.

BROOKLYN TRUST COMPANY, as Trustee of a trust created in and by the will of Susanna E. Coffin, deceased,

Petitioner.

against

CHARLES H. KELBY and CLIFFORD S. KELSEY, as Trustees of the Debtor; PRUDENCE-BONDS CORPORATION (New Corporation); GEORGE E. EDDY; HILDA S. REESE; and PRESIDENT AND DIRECTORS OF THE MANHATTAN COMPANY,

Respondents.

REPLY BRIEF OF PETITIONER

JACKSON A. DYKMAN,
RALPH W. CROLLY,
Counsel for Petitioner.

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against

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Respondents.

REPLY BRIEF OF PETITIONER

As to the Brief of Respondents Other Than Eddy

These respondents state that petitioner's statement of facts is inaccurate and incomplete. This is not true. Respondents have not pointed out in what respects it is not accurate or complete. That the debtor's trustees in 1938 assigned, transferred, and set over all of the right, title, and interest they had in the debtor's property to the new corporation is stated in the petition below of these very respondents (R. 53) so that our statement that the bankruptcy court surrendered control over it is not an assumption but is an uncontroverted fact.

The state court action, contrary to the impression respondents seek to create, was instituted for the purpose of judicially ascertaining whether petitioner and thousands of other former bondholders of the debtor similarly situated have individual causes of action for damages against the former trustees, based on their acts in surrendering some of the debtor's pledged collateral to it, and if the state court determines petitioner has a cause of action to have determined the damages to which it is entitled.

A determination in petitioner's action, whether in its favor or not, will not defeat any liability which may be established against a former trustee, but will declare and make certain the parties to whom such trustee is liable, which is a conceded matter of state law.

If the issues in petitioner's suit are, as respondents assert, misleadingly narrow (which petitioner denies), respondents, who are parties to such suit, may have the issues broadened and fully presented to the state court which they sedulously seek to avoid. The state court suit is not one between petitioner and Manhattan Company alone nor was it secretive. It was openly brought and all of the respondents except the debtor's trustees (who have been *functus officio* since the plans were consummated) *are parties to it and it is therefore in every sense adversary.*[1]

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[1] Petitioner could have brought an action against Manhattan Company alone. It could have submitted the question whether it has a cause of action against Manhattan Company for damages

(Footnote continued on next page)

Respondents were joined as parties to the state court action although no relief is sought against them not only so that they would be fully aware of it but to have an opportunity to present any defense or take any action therein they saw fit, or if they did not wish to be bound by a judgment therein to seek the discontinuance of the suit as to them.

The fact that respondents have been made parties to petitioner's suit and might be bound by *res judicata* is no more an interference with any jurisdiction of the federal court than if they were not parties to it, since the federal court will be obliged in either event to follow the decision in the State Court suit on this question of state law whether in petitioner's favor or otherwise.

Respondents have made no attempt to answer petitioner's claims (1) that the decision of the Circuit Court of Appeals to the effect that petitioner's suit and the accounting proceeding are *in rem* or *quasi in rem* and that petitioner's suit interferes with the jurisdiction of the District Court in the accounting proceeding is in conflict with state law and with the decisions of this court and of other circuit courts of appeals;[2] and (2) that the District Court,

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to the Appellate Division of the New York Supreme Court on an agreed state of facts. Petitioner deliberately made the new corporation and the bondholders Eddy and Reese parties to the state court action so that if the state court decided petitioner had a cause of action against Manhattan Company, they could not thereafter assert the action was fictitious and the decision need not be followed by the federal court although such assertion even in that event would lack merit.

[2] Such decision is also in conflict with the following decisions:

Browning v. *Fidelity Trust Company*, 3 Cir., 250 Fed. 321, cer. den. 248 U. S. 564, recognized the right of *an individual bondholder to bring an action in personam for damages* against a trustee under an indenture which secured the payment of the bonds for an unauthorized release of part of the mortgaged property.

Rheem v. *Allnut*, 64 F. 2d 548. The United States Court of Appeals for the District of Columbia held that when a trustee under a mortgage which secured the payment of notes wrongfully released the entire security so that it was lost, a holder of notes,

(Footnote continued on next page)

since the petitioner was not a party to the debtor's reorganization proceeding or to the accounting proceeding, had no jurisdiction to summarily restrain the prosecution of its suit. All they say is that such decision does not conflict with state law or the decisions of this court or of other circuit courts of appeal because it does not so conflict. Unable to meet petitioner's challenge, they have resorted to the unfounded claim that the state court suit is collusive although they do not dispute that petitioner had a legal right to sue Manhattan Company for damages in the state court.

We submit that the question of the character of the state court action is solely one for the state court to decide. *In each of the cases cited by respondents the court in which the action was brought or an appellate court in the same judicial system decided that question.*

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the payment of which was secured by such released property, *had an individual provable claim for damages against the trustee which was in bankruptcy.*

Young v. *Howard*, 120 F. 2d 712. This same court recognized a suit for damages by a receiver of a note-holder against trustees under a deed of trust for a wrongful release of the mortgaged property which secured the payment of the notes.

American Service Company v. *Henderson*, 4 Cir., 120 F. 2d 525. It was here held that where a corporate debtor acting as a fiduciary had actually converted trust res deposited with it and mingled it beyond identification with its own assets, the claim against it, based on such act, was one "in personam" which was extinguished by the debtor's bankruptcy reorganization proceeding, and it was not, as the claimant contended, an "in rem" claim to specific trust property.

The claims of the affected bondholders, based upon the acts of Manhattan Company in releasing pledged property to the debtor, are ones *in personam*, precisely the same as are those against a trustee *where trust res is lost* by his failure or neglect in collecting or insuring trust property; in selling it at an inadequate price; in making excessive expenditures; in depositing trust funds in a bank which he knows is in a precarious condition and which later fails; in permitting a co-trustee to have sole custody of the trust estate and its misappropriation by the latter; or in not disposing of speculative risks or wasting assets.

If this Court holds this question is properly here then it will be found to have been answered by this Court.

Dickerman v. *Northern Trust Co.*, 176 U. S. 181;
Freuler v. *Helvering*, 291 U. S. 35;
Blair v. *Commissioner*, 300 U. S. 5.

In the *Dickerman* case, a corporate mortgage provided the trustees might declare principal and interest immediately payable if any execution should be levied or sued out against the property of the mortgagor. A bondholder brought an action on six interest coupons. 'The action appears to have been brought directly or indirectly through the legal firm who were also counsel of the defendant company' (p. 189). A summons was issued and served on the president of the corporation who on the same afternoon appeared before a justice of the peace and consented to an immediate trial which resulted in a judgment for $180. Execution was issued at once and 'placed in the hands of the constable at about half past five o'clock of the same day'. Later the same day the trustees gave notice declaring the principal and interest due on all the bonds. 'It also appeared that the president of the company had been in consultation with the attorneys of the trustees about foreclosing the mortgage and taking possession of the property for several days prior to January 22', the day the action was commenced and expedited to its conclusion.

In a suit to foreclose the mortgage intervening stockholders of the corporate mortgagor filed an answer in which, *inter alia*, they alleged that the judgment and execution described above was a fraudulent and collusive act.

A master and all the courts before which the question was presented held the bondholder's action was not collusive. As shown by the opinion of this court the test is whether there is a real cause of action between the parties and, if there is, 'it is no defense that the plaintiff may have had some ulterior object in view beyond the recovery of the

judgment, so long as such object was not an unlawful one' (p. 190).

In *Freuler* v. *Helvering,* the Commissioner assessed a deficiency in income taxes against the beneficiary of a trust. The question was whether under the law of California the portion of gross income allocated for depreciation was distributable to the beneficiary. While an appeal from the deficiency assessment was pending before the Board of Tax Appeals the trustee, *for the first time in fifteen years,* filed an account in the state court which held that the life tenant must repay to the trustee the amounts which he should have reserved each year for depreciation. No appeal was taken from this decision. Thereupon the Board reversed the Commissioner, holding the decision of the state court conclusive. The Circuit Court of Appeals reversed the Board and this court granted certiorari.

An additional element in the case was the fact that after the decree in the state court the beneficiaries, instead of repaying the trustee the amounts found due him, gave their notes which were without interest and payable to the order of those who should be entitled in remainder at the termination of the trust.

The Commissioner suggested that the proceeding in the state court was collusive in the sense that all the parties joined in the submission of the issues and sought a decision which would adversely affect the Government's right to additional income tax. This Court held that the proceeding in the state court was not collusive, the opinion ending as follows:

> 'We cannot seize on the form of the settlement made between the parties either to impugn the good faith and judicial character of the state court's decree, or to ignore the decree and its conclusiveness as to what was in fact and in law income distributable to the beneficiaries under the trust' (p. 47).

This case is authority therefore that while a federal proceeding is pending it is not collusive to institute a proceed-

ing in a state court for the settlement of a question of law which will establish conclusively the law which the federal court must follow.

In *Blair* v. *Commissioner,* the beneficiary of a testamentary trust executed assignments of income in favor of his children. The Commissioner held the assignments invalid upon the ground that the trust was a spendthrift trust and assessed a tax on the entire income against the beneficiary. The Board of Tax Appeals reversed the Commissioner and was in turn reversed by the Circuit Court of Appeals (*Commissioner* v. *Blair,* 60 F. 2d 340) upon the ground that under the law of Illinois the income of the trust was not assignable and *certiorari was denied* (288 U. S. 602).

Just as in the present case *after denial of certiorari* a suit was then instituted in the state court for a construction and instructions. All the beneficiaries were joined *but no notice was given the Commissioner.* The assignments were held valid on an appeal to an intermediate appellate court of the state, no appeal being taken to the court of last resort.

At that time proceedings were pending before the Board of Tax Appeals to review assessments for later years. The Board received the record in the state court and, holding its decision conclusive, reversed the Commissioner. On appeal the Circuit Court of Appeals reversed the Board (*Commissioner* v. *Blair,* 83 F. 2d 655) and discussed the question of collusion in its opinion, putting particular emphasis on the fact that the Commissioner was not represented in and had no notice of the state court action (p. 657). This court reversed and dismissed the question of collusion in these words:

> 'Nor is there any basis for a charge that the suit was collusive and the decree inoperative. *Freuler* v. *Helvering, supra.* The trustees were entitled to seek the instructions of the court having supervision of the trust. That court entertained the suit and the appellate court, with the first decision of the Circuit Court of Appeals before it, reviewed the decisions of the

> Supreme Court of the State and reached a deliberate conclusion. To derogate from the authority of that conclusion and of the decree it commanded, so far as the question is one of state law, would be wholly unwarranted in the exercise of federal jurisdiction' (300 U. S. at p. 10).

The attitude of the state court upon this subject is shown in the recent decision in *Heyman et ux* v. *Heyman et al.*, 33 N. Y. S. 2d 235. There the plaintiff conveyed securities to himself and his wife as trustees for their son, with remainders to other children, all of whom were infants, retaining broad powers of control and management. The Board of Tax Appeals held the donor had power under the instrument creating the trust to revest the entire trust principal in himself and on that basis determined that a capital gain was taxable to him individually. The trustees then brought this action in the state Supreme Court for a construction of the trust instrument to which the infant beneficiaries were made defendants. On plaintiff's motion for judgment on the pleadings the United States, *which had not been made a party,* filed a brief as *amicus curiae* in which it was urged that the purpose of the action was merely to obtain a construction of the trust which it was hoped would help the plaintiff individually on an appeal from the decision of the Board of Tax Appeals. Mr. Justice VALENTE construed the trust instrument and held the action entirely proper and not collusive.

Against the principle established by these cases respondents present decisions involving an entirely different factual situation to support abusive characterization of certain parties to the state court action.

Lord v. *Veazie,* 8 How. 250, cited by respondents, involved a fictitious cause of action every element of which had been created by the parties for the purpose of instituting suit on it. In August Veazie executed an instrument purporting to convey stock of a railroad corporation to Lord. The instrument contained a covenant that the stock-

holders of the corporation had the right to use the waters of the Penobscot river for navigation. In September the action for breach of this covenant was docketed by consent and a statement of facts agreed upon by counsel for the parties. In October judgment was taken *pro forma*, the effect of which was to adjudicate that the stockholders had the right to use the river for navigation. The case was brought to the Supreme Court on writ of error. A motion was then made by Moor, who claimed the sole right to navigate the river under a statutory grant from the state legislature, to dismiss the appeal upon the ground that the case was fictitious and collusive and based on a feigned issue. This Court dismissed the writ, stating it was "satisfied, upon examining the record in this case, and the affidavits filed in the motion to dismiss, that the contract set out in the proceedings was made for the purpose of instituting this suit, and that there is no real dispute between the plaintiff and defendant" (p. 254). *The Court also rested its decision upon the fact that parties adversely interested had had no opportunity of being heard in defense of their rights* (id.).

Van Horn v. *Kittitas County*, 112 F. 1, was an action for breach of a contract on the part of the county to issue and sell bonds. The county had advertised for bids for the proposed bonds and plaintiff's assignors were the highest bidders. The county accepted the bid on condition that the bidders would cause a suit to be brought against the county and prosecuted to final determination in the supreme court of the state for the purpose of testing the validity of the bonds, the cost of the litigation, not to exceed $500, to be borne by the county. The bidders caused the litigation to be instituted and prosecuted to a final determination in the supreme court. The county then refused to deliver the bonds and sold them to another purchaser at a higher price. The court sustained a demurrer to the complaint holding the action in the state court collusive and saying:

> 'From the allegations of the complaint, and the necessary inferences to be drawn therefrom, the con-

> tract sued upon contained a condition precedent; that is to say, the county was not obligated to issue its bonds unless Farson, Leach & Co. should first be instrumental in causing litigation, and securing a decision of the supreme court of the state affirming the validity of the bonds. The agreement, therefore, was not divisable, and, as the only obligation of the county was made dependent upon performance of the condition by Farson, Leach & Co. the contract is entirely void if performance of the condition was unlawful' (p. 2).

The court then proceeded to hold the condition unlawful on the authority of *Lord* v. *Veazie, supra.*

Here, again, a contract was made for the purpose of instituting litigation to determine a pretended dispute between the parties.

Bell & Howell Co. v. *Bliss, et al.*, 262 F. 131, was a suit in equity for the infringement of a patent. Appellant made a contract with appellee Spoor granting him an exclusive right to use a machine that embodied a patent and agreeing to sell machines at a fixed price. Spoor defaulted on payments under the contract and appellant sued him and recovered judgment in a state court. As various later instalments came due and were unpaid similar actions were commenced. While these actions were pending Spoor paid the purchase price of another patent which was assigned to the appellee Bliss who then brought this action, joining Spoor as a defendant and alleging infringement. Spoor then filed a cross bill alleging his contract with appellant and asking an injunction restraining it from prosecuting its actions against him in the state courts. The court found it appeared from the report of a master that the second patent was acquired for the purpose of bringing suit and defeating and delaying appellant's actions in the state court, that appellee Bliss never had any interest in the patent or any connexion with the litigation and was ignorant of the contents of the bill. On this state of facts the court said:

> 'That this conduct is such as to justify a denial of all relief and a dismissal of the bill can hardly be

> seriously questioned. The conclusion that the present suit is for the sole purpose of hindering and delaying the proceeding in the state court is most amply supported by the testimony. Nor can the jurisdiction of the state court, upon the facts disclosed and for the relief sought, be questioned. The present suit, then, bluntly expressed, was but a means whereby Spoor, hardpressed in the state court, *using a dummy (Bliss) to conceal his own identity*, sought to do indirectly and deceptively what he could not do directly and openly—interfere with the orderly proceedings of the state court' (p. 134). (Italics supplied).

Again we have facts created for the purpose of litigation as distinguished from a preexisting right which a plaintiff contends is recognised by the state courts and which he wishes to vindicate in them.

Judson v. *Flushing Jockey Club*, 14 Misc. 350, was an action to recover a sweepstake. After a judgment for defendant the state racing commission and a number of racing organisations intervened on appeal and objected to argument on the ground that the action was fictitious and 'framed and propounded by a person who, in fact, is at once plaintiff and defendant'. The General Term of the New York Common Pleas ordered a reference to determine the facts.

Matter of V, 10 App. Div. 491, was a disciplinary proceeding against an attorney. He was charged, *inter alia*, with having caused a fictitious case to be prepared and submitted pursuant to section 1279 of the Code of Civil Procedure. Discussion of this charge is found at page 506 of the opinion.

Here, again, a contract was prepared and executed for the purpose of bringing suit.

The case of *United States et al.* v. *Johnson*, decided May 24, 1943, The United States Law Week, Volume 11, page 4420, is in no way factual or otherwise analogous to the case here; *contra*, this decision supports petitioner's claim that whether an action is collusive is a matter for deter-

mination by the court in which it is brought, or by an appellate court to which an appeal is taken from the decision of such court sustaining the action.

In the decisions in *Dickerman* v. *Northern Trust Co.*, *Freuler* v. *Helvering*, *Blair* v. *Commissioner* and *Heyman* v. *Heyman*, *supra*, where collusion is defined, it is established that the right to vindicate a preexisting right *in a state court* cannot be affected by the fact that in a proceeding pending in a federal court the decision of the state court will be conclusive. All the elements present here were present in the *Blair* case even to the commencement of the action in the state court after denial of certiorari by this court.

The decisions of this court which we have cited establish that the test of collusion is whether the cause of action existed before the 'ulterior object in view beyond the recovery of the judgment' (*Dickerman* v. *Northern Trust Co.*, *supra*) or the basis of the cause of action was created for the sole purpose of attaining the ulterior object.

> *May Hosiery Mills* v. *U. S. District Court*, 64 F. 2d 450, 453, et seq. *Wilmington W. R. Co.* v. *Board of Railroad Comrs.*, 90 F. 33, 37.

If the basis of the cause of action already existed and was not created *pro hac vice* then as in the present case the action is not collusive under the cases cited.

Assume for argument that Brooklyn Trust Company and Manhattan Company arranged to bring the action under attack for the ultimate object of obtaining a decision on a question of state law in conflict with that in *Manufacturers Trust Co.* v. *Kelby*. The acts of Manhattan Company upon which the action is based occurred several years before the objections to the accounts of the corporate trustees were filed in the debtor's reorganisation. Neither Brooklyn Trust Company nor Manhattan Company has done a single act designed for pleading in the complaint or answer. The estate of Susanna E. Coffin demands judg-

ment for damages against Manhattan Company payable by it personally out of its own funds for acts which these respondents themselves assert it did years before any ulterior object with which petitioner can now be charged could possibly have been conceived. Clearly respondents believe the Coffin estate has a valid cause of action despite the decision in *Manufacturers Trust Co.* v. *Kelby*, otherwise instead of striving so lustily to prevent its being decided in the court where it belongs they would contest the action.

The cases cited by respondents on page 7 of their brief are in no way apposite. Even if petitioner's suit in the state court were not one for damages but for a declaratory judgment for a judicial definition of its rights against Manhattan Company, it would under New York law have a constitutional right to maintain such action.

Re Brief of Respondent Eddy

Counsel for this respondent has submitted a brief which might be appropriate in the state court in the action which has been enjoined. Most of the brief is devoted to an argument that petitioner has no cause of action against the former trustee. That is the question for the state court, and the argument on this point is premature and is presented in the wrong forum. The question is not whether petitioner has a cause of action but whether it has the right to have that question determined now by the state court.

This respondent argues (which is not material here) that petitioner does not have a cause of action against Manhattan Company and at the same time inconsistently asserts that petitioner had a cause of action against the debtor because it acted jointly with the former trustee in withdrawing collateral and, therefore, concludes that petitioner was a party to the debtor's reorganization proceeding.

A party to a bankruptcy or to a bankruptcy reorganization proceeding is one whose claim has been judicially allowed. The allowance by the court in bankruptcy or reorganization of a party's claim is his admission into the

proceeding and without such allowance he is not in the proceeding and has no standing to in any way participate therein. There were never listed in the debtor's reorganization proceeding as creditors of the debtor its former bondholders who were not such bondholders at the time of the filing of its petition for reorganization, but who were such bondholders when the debtor made the withdrawals of collateral, nor were they ever classified; nor were any such claims which such former bondholders had against the debtor because of such withdrawals while they were bondholders, ever allowed. These parties consequently were never parties to the reorganization proceeding, nor to the subsequent accounting proceeding.

This respondent has conceded that the claims urged in the accounting proceeding are in personam and that there is no res over which the bankruptcy court has jurisdiction. (See footnote 5, main brief, page 25.)

The decision of the Circuit Court of Appeals is also in conflict with the rule established by the following decisions:

Even if the accounting proceeding of Manhattan Company in the District Court was assumed to be one in rem, the rule, however, is that the pendency of a proceeding in rem in one court does not preclude the granting in another court of *any* relief subsequently sought that does not conflict with the first court's control of specific property to which the jurisdiction in rem has attached. *Purcell* v. *Summers*, 4 Cir., 126 F. 2d 390, 395; *Wanamaker* v. *Eaves*, 4 Cir., 79 F. 2d 553; *Newberry* v. *Davison Chemical Co.*, 4 Cir., 65 F. 2d 724, 728; see also *Commonwealth Trust Company* v. *Bradford*, 297 U. S. 613, cited in main brief; *Watson* v. *Jones*, 13 Wall (80 U. S.) 679.

In *Wanamaker* v. *Eaves*, supra, the court held that the order of the federal court enjoining proceedings in the state court suit wherein some of the proceedings actually interfered with previously acquired jurisdiction of the federal court in a suit by a receiver of an insolvent national

bank to distribute property held by the bank should be modified so as to restrain the parties only to the extent of pursuing any remedies in the state court which would interfere with the jurisdiction of the federal court to hold, liquidate, and distribute assets brought under its jurisdiction *but not to interfere with the state court in passing on issues properly involved in the suit.*

The course which the Circuit Court of Appeals should have followed, even assuming arguendo only the accounting proceeding in the District Court were in rem or quasi in rem, is that prescribed by this Court in *Watson* v. *Jones*, 13 Wall (80 U. S.) 679, 720, i. e., *the state court, since control of any res by it is not essential to the maintenance of petitioner's action there,* should not have been restrained from granting any relief appropriate under the pleadings which would not interfere with any assumed specific property brought within the jurisdiction of the District Court, that is, *to decide whether petitioner has a cause of action against the former trustee.*

Meredith v. *City of Winter Haven*, 5 Cir., 134 F. 2d 202, 207, 208, holds that federal courts, although possessing jurisdiction because of diversity of citizenship, where the questions presented for decision are those of state cognizance, will not exercise their jurisdiction to determine such issues where the state court jurisprudence in regard to such questions is not definitely settled. Cf. *Burford* v. *Sun Oil Co. and Hastings* v. *Selby Oil & Gas Co.*, decided by this court on May 24, 1943, 11 U. S. Law Week, 4410.

May 28, 1943.

Respectfully submitted,

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